Supreme Court, U.S.
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No. 93-_____

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

C.L. GRIMES and G.W. HOLBROOK, on their own behalf and on behalf of all persons similarly situated,
Petitioners,

v.

VITALINK COMMUNICATIONS CORPORATION, a Corporation; NETWORK SYSTEMS CORPORATION, a Corporation; LESLIE G. DENEND, J. DANIEL MCCRANIE, CHARLES J. ABBE, HARRY T. REIN, and LYLE D. ALTMAN,
Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

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PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The court below approved a state court's extinguishing a federal cause of action over which Congress denied it any jurisdiction. An academic friend has remarked that he could teach two-thirds of his Federal Courts course from this case, for the opinion below wrongly decided at least seven questions of law, every one of which warrants this Court's attention:

1. Can a state court force upon a person, by the device of a non-opt-out class action under state law, an agent clothed with power to release that person's federal securities law claims, notwithstanding that Congress has expressly deprived state courts of any authority over such claims?

2. At a state court hearing on whether to approve a class action settlement, there is no presentation of evidence or decision on the merits; the court merely generally evaluates, in the light of its business judgment, what the respective sides would give up and receive in the settlement. If at such a hearing a person does no more than argue that the settlement should not be approved because it purports to bargain away substantial claims (including federal claims which were not, and could not have been, presented in the action), has the person thereby "actually litigated" the facts of those claims, so as to be foreclosed by issue preclusion from presenting them in a subsequent federal action?

3. Over and above these two key issues, did the court below err in holding:—

(a) That if a nonresident stockholder in a Delaware corporation sells his stock, in New York, to a third party in response to a tender offer, that is a sufficient "minimum contact" with Delaware to support personal jurisdiction, at least if there is pending some Delaware state lawsuit,

related to the tender offer, in which a class including the stockholder might be certified?

(b) That a state can empower the representative plaintiff in a non-opt-out equitable class action to give a release, binding on all class members, of damage claims at law?

(c) That a state can empower the representative plaintiff in a non-opt-out class action to give a release, binding on all class members, of claims based on a different set of facts from those on which the class action is based?

(d) That a class member who does not appear in a class action is precluded from any subsequent collateral attack on the judgment in the action?

(e) That a class member who objected to a class action settlement is precluded from thereafter contending that the court's response to his objection was constitutionally inadequate?

PARTIES TO THE PROCEEDING

The names of all parties appear in the caption of the case.

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On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

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PETITION FOR A WRIT OF CERTIORARI

C.L. Grimes and G.W. Holbrook respectfully petition the Court for a writ of certiorari to review the judgment of the United States Court of Appeals for the Third Circuit in this proceeding.

I. JURISDICTION

The opinion below, 17 F.3d 1553, reprinted at pp. 1a-41a of the Appendix ("App."), affirmed a judgment of the

District Court for the Eastern District of Pennsylvania (opinion reported only in computer services; reprinted at App. 42a). The opinion below was issued on March 9, 1994. Petitioners, plaintiffs below, timely petitioned for rehearing and suggested rehearing in banc, denied April 6, 1994. App. 86a. This Court has jurisdiction to review the judgment by certiorari under 28 U.S.C. § 1254(1).

The case involves the Supremacy Clause, the Due Process Clauses of the Fifth and Fourteenth Amendments, the Full Faith and Credit Act, 28 U.S.C. § 1738, and Rule 23 of the Rules of the Court of Chancery of Delaware. These are reproduced at App. 94a.

II. STATEMENT OF THE CASE

In summary: This is a federal securities action arising from a tender offer. The petitioners, plaintiffs below, had been included by a state court in a non-opt-out class action involving a different claim relating to the tender offer, arising under state law. The "representative" plaintiff in that case had settled and given a broad general release of all claims related to the tender offer. The court below held that that release precludes this action, even though Congress has denied the state courts any jurisdiction over federal securities claims; and held that petitioners are precluded from questioning the state court settlement in this proceeding.

Petitioners Holbrook and Grimes live in Connecticut and Pennsylvania respectively. Respondent Vitalink was a California-based business incorporated in Delaware. Respondent Network Systems Corporation ("NSC") is a Minnesota-based business incorporated in Delaware. The individual respondents were officials of Vitalink and NSC.

Holbrook and Grimes were substantial Vitalink stockholders, with holdings of over $2,000,000 even at the $10.50 price described *infra*. In May 1991, management of Vitalink and NSC agreed on an arrangement for Vi-

talink to become a wholly-owned subsidiary of NSC, and on May 7, 1991, NSC announced a tender offer for Vitalink stock at $10.50 a share. Holbrook tendered his shares; Grimes did not.

When the tender offer successfully closed on June 20, NSC bought the tendered shares (including Holbrook's) and became a 90% owner of Vitalink. By letter of July 11, the non-tendering stockholders (including Grimes) were notified that they had been "squeezed out" under Delaware law on July 1, *i.e.*, their shares had been transformed into rights to receive $10.50 per share or to seek appraisal, and NSC had become the 100% owner.

It transpired that important information on the stock's value had been withheld. Grimes and Holbrook accordingly brought this action for damages against Vitalink, NSC, and various officials of the companies for violations of §§ 10(b) and 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j and 78n(e), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5. Jurisdiction in the court of first instance was based on 15 U.S.C. § 78aa and 28 U.S.C. § 1331. Federal jurisdiction is exclusive. 15 U.S.C. § 78aa.

The district court dismissed on the ground of a release signed by three lawyers, strangers to Holbrook and Grimes whom they had never authorized to release their claims.

That came about thus. As soon as the proposal was announced the plaintiffs' class action bar had raced to the courthouse. Within a few days, seven similar complaints had been filed, four as class actions in the Court of Chancery of Delaware under Rule 23 of its rules (substantially identical to FED. R. CIV. P. Rule 23, App. 95a), and three in California state courts. The earliest complaint, *John P. McCarthy Profit Sharing Plan* v. *Vitalink Communications Corp.*, was representative and was designated as the con-

solidated complaint.[1] It charged (on what basis is unclear) that respondent Denend (Vitalink's CEO) and others of Vitalink's management, by the offer of lucrative jobs with NSC, had been induced to sell out to NSC without taking steps to maximize Vitalink's value in the marketplace; thus breaching their fiduciary duties of loyalty and care. App. 101a-105a. It was a purely equitable action for a declaration and an injunction or rescission, with unspecified damages mentioned only in passing. App. 105a.

The Delaware complaint and the complaint in this case are reprinted at App. 99a and 107a; their key portions are laid side by side in Table 1, App. 122a. The Delaware action was based exclusively on management's alleged putting of their own interests first. *It was not an action for breach of any duty of disclosure and made no allegation of that kind.* Aside from the basic story of the tender offer itself, *the Delaware action had little or no factual overlap with a disclosure case such as the present one.* See Table 1, App. 122a.

Barely three weeks later, the lawyers for the Delaware plaintiffs had already struck a deal. Vitalink and NSC agreed to trivial changes in the tender offer, and agreed not to oppose a generous fee ($275,000, or over $500 an hour) to the plaintiffs' lawyers, to be paid by Vitalink. In exchange, the plaintiffs' lawyers agreed to a release of *all* claims arising out of the tender offer, broad enough to (purportedly) include federal claims. App. 92a-93a.

The deal was signed as of June 10. Not till July 16, after the acquisition and "squeezeout" were consummated, was it presented to the Court of Chancery for approval. That court certified on July 18 a *non-opt-out* class of stockholders (including Grimes and Holbrook). It did so without finding that the "representative" plaintiffs fairly repre-

[1] The other suits added nothing and the California cases remained dormant until released in the settlement; so, like the state courts and the courts below, we will deal only with the *McCarthy* complaint.

sented the class, and to this day nobody but the "representative" plaintiffs and their lawyers knows how much stock they had and whether they had a more than trivial interest in the matter. (The Supreme Court of Delaware has since decreed that such a finding must be made in all class action settlements. *Prezant* v. *DeAngelis,* 636 A.2d 915 (Del. 1994)). On July 29 the court sent out a notice of settlement hearing.

Holbrook did not appear at the settlement hearing. Grimes did, and objected to the settlement as a sham on two grounds. *First,* he challenged its adequacy. In return for only cosmetic changes, the sweeping release would purportedly give up all claims—including the disclosure claims here involved, which had been neither advanced nor explored by the "representative" plaintiffs' lawyers. *Second,* he contended that the "representative" plaintiffs had not adequately represented the class, and that accordingly a record sufficient to evaluate the settlement had not been developed. He pointed to the small amount of discovery taken, the lack of any expert review of the company's investment bankers' work, the non-adversary tenor of key depositions, and a "runaround" in efforts to get information as to the *bona fides* of the lawsuit and the settlement negotiations.

Grimes had no opportunity to contest the certification of a non-opt-out class. That was a *fait accompli.*

The settlement hearing was held on written submissions and oral argument, without formal evidence or testimony. This is normal Delaware practice. *The court does not decide the merits of the case or of any other claim that may be discussed in evaluating the settlement;* rather, it generally evaluates the claims and their likelihood of success, and balances, based on its business judgment, its appraisal of what is being received against its appraisal of what is being given up. *E.g., Barkan* v. *Amsted Industries, Inc.,* 567 A.2d 1279 (Del. Super. 1989); *Rome* v. *Archer,* 564

A.2d 1089 (Del. Super. 1989); *Polk* v. *Good*, 507 A.2d 531 (Del. Super. 1964).

On November 8, the court approved the settlement, *In re Vitalink Communications Corporation Shareholders Litigation*, [1991-92 Transfer Binder] FED. SEC. L.REP. (CCH) ¶ 96,585, App. 53a—even though it found the "benefits" conferred on the stockholders to be of merely "speculative" value, App. 82a; found it "troubling" that the "representative" plaintiffs had misrepresented the record, App. 64a n.1; and found that a "cloud of doubt" which the Vitalink board should have "*fully* accounted for" (emphasis original) remained on Vitalink's investment banker's valuation analysis. App. 69a-70a. The court discussed three specific failures to disclose that Grimes had pointed to, and appraised them as not material. App. 76a-80a. It summed up by saying that "[a]s far as the claims that could be asserted" but were not (such as disclosure claims), "there is no indication of their merit," App. 82a, and that "due care and candor claims carry very little chance of success at trial." App. 85a. As for the duty of loyalty and care claims *actually* asserted by the "representative plaintiffs", it concluded that they were "very weak." App. 82a. The court did not even discuss Grimes's contention that the class had not been fairly represented. It did hold that the record was "sufficiently developed" to provide "an adequate basis upon which . . . to determine whether the Settlement Agreement was fair . . . ." *Ibid.* It accordingly approved the settlement. The Supreme Court of Delaware affirmed *per curiam*. 610 A.2d 725 (1992).

The Court of Chancery ignored a constellation of suspicious circumstances pointing to a sham settlement, including settlement before class certification, attorneys' fees to be paid by defendants with a "clear sailing" agreement, an extraordinarily high fee, no evidence to justify its amount, evasiveness about the deal, minimal discovery, speculative benefits, and a sweeping release. Grimes accordingly petitioned this Court for certiorari on the ques-

tion of what minimum procedural requirements due process obliges a state court to observe in reviewing a class action settlement as to fair representation. This Court denied certiorari. *Grimes* v. *John P. McCarthy Profit Sharing Plan*, 113 Sup. Ct. 179 (1992).

Meanwhile, Grimes and Holbrook had filed the instant action. The cause of action asserted (inadequate disclosure under federal law in the sale of their stock by the stockholders to an outside party; no fiduciary duty claims) has next to nothing in common with the cause of action asserted in the state case (breach of directors' state law fiduciary duty of due care and loyalty to the stockholders; no disclosure claims) and next to no issues of fact in common with it. Once again, see Table 1, App. 122a. Moreover, unlike the state *equity* case, this action is at *law* for very substantial *money damages* with a jury. The district court held that the release in the Delaware settlement barred the action. The court below affirmed.

The reasoning below is not easy to follow and, with respect, the opinion is replete with misapprehensions of fact. We believe the following is a fair summary.

To begin with, the opinion never directly addresses the key question of where a state court could purport to get the power to force upon Grimes and Holbrook an agent authorized by it to release claims over which Congress had denied it all jurisdiction. It approaches the matter, not from the crucial viewpoint of the court's *subject-matter* jurisdiction, but rather from the irrelevant viewpoint of the state court's *personal* jurisdiction over Grimes and Holbrook. It held that the Delaware court had personal jurisdiction over Grimes because he "appeared at the settlement hearing to litigate [*sic*] his objections." App. 11a n.5. It held that the Delaware court had personal jurisdiction over Holbrook on the ground that his owning stock in a Delaware corporation and tendering his shares supposedly "with knowledge of his status as a member of

the plaintiff class in a pending class action lawsuit" containing appropriate procedural protections gave him sufficient "minimum contacts" with Delaware. App. 13a. It held that because the state court thus had personal jurisdiction over Grimes and Holbrook, the principle of *Phillips Petroleum Co.* v. *Shutts*, 472 U.S. 797 (1975), did not require opt-out in the state court proceeding. App. 14a-16a.

It then concluded that the release in the state equity suit, and Grimes's participation in the settlement hearing, preclude this federal damages action at law under the Full Faith and Credit Act, 28 U.S.C. § 1738, as interpreted in *Marrese* v. *American Academy of Orthopaedic Surgeons*, 470 U.S. 373 (1985), because "a state court would conclude that the plaintiffs are collaterally estopped from relitigating [*sic*] the factual issues of nondisclosure, adequacy of representation, and fairness of the settlement . . . ." App. 20a. Underlying this proposition was the mistaken concept that all these issues had indeed been actually "litigated" in the state court by Holbrook (who never appeared there) and by Grimes. App. 17a-19a.

The majority opinion thus stands for at least the following propositions of law (among others):

Proposition 1. A state court can force upon a person, by the device of a non-opt-out class action, an agent clothed with power to release that person's federal securities law claims, notwithstanding that Congress has expressly deprived state courts of any authority over such claims.

Proposition 2. For a class member merely to appear at a settlement hearing and argue that the settlement should not be approved because it purports to bargain away substantial federal disclosure claims which were not (and could not have been) presented in the state class action, constitutes "actual litigation" of the facts of those claims, resulting in issue preclusion in a subsequent federal action—even though at the hearing evidence is not presented, the merits are not decided, and the court merely

generally evaluates the claims within the context of an overall appraisal of the settlement in the light of its business judgment.

Proposition 3. If a nonresident stockholder in a Delaware corporation tenders his stock (outside Delaware) to a third party in response to a tender offer, that is a sufficient "minimum contact" with Delaware to support personal jurisdiction, at least if there is pending some Delaware state lawsuit related to the tender offer transaction in which a class including the stockholder might be certified.

Proposition 4. A state can empower the representative plaintiff in a non-opt-out equitable class action to give a release, binding on all class members, of damage claims at law.

Proposition 5. A state can empower the representative plaintiff in a non-opt-out class action to give a release, binding on all class members, of claims based on a different set of facts from those on which the class action is based.

Proposition 6. A class member who does not appear in a class action is precluded from any subsequent collateral attack on the judgment in the action.

Proposition 7. A class member who objected to a class action settlement is precluded from thereafter contending that the court's response to his objection was constitutionally inadequate.

III. REASONS FOR ALLOWANCE OF THE WRIT

A. The Decision Below Gives Approval to the Key Element of a Major Abuse of Class Action Procedure

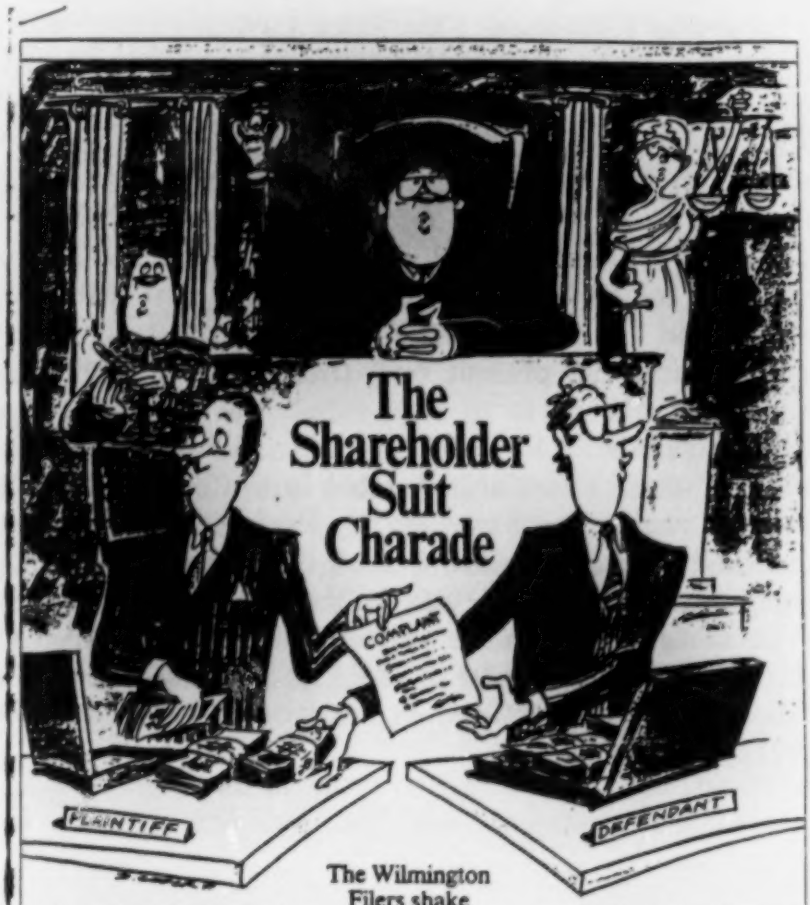
This past January 26, the Chairman of the SEC voiced "concerns about private securities litigation and the role it plays in the vital process of capital formation." *Remarks*

by Chairman, Arthur Leavitt . . . Securities Regulation Institute, U. of Calif. San Diego, January 26, 1994, at 2. Among "indications that our current system is flawed," he mentioned that "virtually all securities class actions are settled for some fraction of the claimed damages, and some allege that settlements often fail to reflect the underlying merits of the cases." *Id.* at 3. He criticized law firms' "maintaining an inventory of shareholders to serve as nominal plaintiffs in class action filings," and expressed his "especial[] interest[] in ways to give shareholders greater control over their own litigation and curb potential conflicts of interest between class action lawyers and the shareholders they represent." *Id.* at 6.

A major target of these strictures is the "Delaware settlement," which has become, like the "Nevada divorce," a classic abuse that brings scorn on the legal system. Holding in readiness a stable of clients who own stock—often, it seems, in only trivial amounts—in nearly every publicly traded company, a relatively small number of lawyers scrutinize the business news, and immediately upon sighting a transaction that *might* be vulnerable to a claim of breach of duty by a company's directors, file a non-opt-out class action in equity against the company in state court under state law. After minimal discovery, the claim is settled for a cosmetic consideration and a large attorney's fee. The lawyer—theoretically, of course, the "class representative"—gives in return a general release that purports to cover all claims arising out of the transaction. The state court approves the settlement. The only winners, of course, are the lawyers and the defendant companies, who are happy to pay the lawyers generously for such a "plenary indulgence" or "vaccination." Substantial stockholders with genuine claims are frozen out.

The legal trade press has long regarded the "Delaware settlement" as, quite simply, a scandal. We respectfully refer the Court in particular to *The Shareholder Suit Charade: The Wilmington Filers shake down corporations in*

Delaware, and no one seems to mind, AMERICAN LAWYER (Dec. 1989) 67. Rather than quote from the text, we ask the Court's indulgence for our reproducing its first page, on the theory that quoting one picture is worth quoting a thousand words.



The Wilmington Filers shake down corporations in Delaware, and no one seems to mind.

By Anthony Borden

At an August settlement hearing in Delaware's court of chancery Steven Schulman, an associate at New York's premier shareholders firm, 72-lawyer Milberg Weiss Bershad Specthrie & Lerach, tried to explain exactly what his suit against Champion Spark Plug Company and its two bidders had accomplished. What "consideration" had the plaintiffs won in return for releasing their accusations? Why should the plaintiffs' counsel get paid?

It wasn't easy.

"This was not a lay-down litigation," argued Schulman, 38. "If we had filed a boilerplate complaint and sat on this case on day one . . . I would say to Your Honor I would have a problem coming here be-

Legal scholars have likewise expressed dismay over the phenomenon. "Much like the production of sausage and legislation," Professor John C. Coffee, Jr., of Columbia Law School has written, "the settlement of securities litigation is a process that the high-minded are best advised not to examine too closely." Coffee, *Suspect Settlements in Securities Litigation*, NEW YORK LAW JOURNAL, March 28, 1991, p. 5 col. 1. At least two major studies corroborate what Professor Coffee described as the long-available anecdotal evidence that "the result can be collusive settlements in which low recoveries are exchanged for high plaintiffs' attorneys fees." *Ibid.* In one, Professor Roberta Romano of Yale studied 83 settlements of stockholder actions and confirmed, among other things, that attorneys' fees loomed far larger than plaintiffs' recoveries. In settlements (like the present one) that afforded only structural relief, the value of such relief, she concluded, was "inconsequential." Romano, *The Shareholder Suit: Litigation Without Foundation?*, cited in Coffee, *Suspect Settlements, supra.* Another study, by Professor Janet Cooper Alexander of Stanford Law School, demonstrated that "the strength of the plaintiffs' case on the merits did not appear to be a significant factor in determining the outcome." Alexander, *Do the Merits Matter? A Study of Settlements in Securities Class Actions*, 43 STANFORD L. REV. 497, 500 (1991).[2]

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[2] See also, *e.g.*, Coffee, *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 714-20 (1986); Coffee, *The Unfaithful Champion: The Plaintiff As Monitor in Shareholder Litigation*, 48 LAW & CONTEMP. PROBS. (Summer 1985) 5, 26-33; Coffee, *Rescuing the Private Attorney General: Why the Model*

More recently, the matter has boiled over into the general press. *"Millions for Us, Pennies for You,"* trumpeted a headline in the *New York Times* a few months ago, with the subhead: *"Suits on behalf of investors enrich lawyers. But what of their clients?"* NEW YORK TIMES, December 19, 1993, Section 3, p. 1. ("[T]he law firms representing these investors can win approval for settlements of a few cents on the dollar for their clients while pocketing millions of dollars—even tens of millions—for themselves. . . . 'The only people who make money in these are the claimants' lawyers, and the defendants themselves, who shut off a lot of potential liability.' . . . 'The lawyers' interest shifts from protecting the investor to protecting the deal.' ") See also Moses, *Off to Court: Lawyer Given To Filing Shareholder Lawsuits Comes Under Scrutiny,* WALL ST. JOURNAL, October 28, 1992, p. 1, col. 8.

Earlier last year, the practice of maintaining a stable of stockholders from which plaintiffs could be "pressed into service at the drop of certain stock prices" received general publicity as a result of *Greenfield* v. *U.S. Healthcare, Inc.*, 146 F.R.D. 118 (E.D. Pa. 1993). See, *e.g.*, Moses, *Three Shareholder Lawyers Sanctioned,* WALL ST. JOURNAL, February 5, 1993, p. B7, col. 1.

According to an industry newsletter, in 1993 the eleven law firms involved in the greatest number of

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of the Lawyer as Bounty Hunter Is Not Working, 42 MD. L. REV. 215, 232-33, 239-40 (1983). See also *Private Litigation Under the Federal Securities Laws: Hearings Before the Subcommittee on Securities of the Senate Committee on Banking, Housing, and Urban Affairs,* S. HRG. 103-431, 103D CONG., 1ST SESS. 44-46, 117, 305-307, 416-417, 458, 461-62, 602 (1993).

settlements of stockholder class-action lawsuits were in an average of 18.5 such settlements each, or one every three weeks. The top firm was involved in 40 such settlements, and the runner-up in 26. Bowers & Gupta, *Shareholder Suits Beset More Small Companies,* WALL ST. JOURNAL, March 9, 1994, p. B1, col. 5.

Adverse public attention to class action settlements is not, of course, restricted to securities cases. See, *e.g.,* a lead editorial headed *"Coupon Clipping for Lawyers"* in the WALL STREET JOURNAL, November 18, 1993, p. A20, col. 1. ("[W]e have a hard time believing the lawyers deserve their money for producing a settlement in which all the real money goes to the lawyers. . . . Funny, we thought the justice system was supposed to have something to do with, well, justice.") See also Baron, *An Asbestos Settlement With a Hidden Agenda,* WALL ST. JOURNAL, May 6, 1993, p. A11, col. 3; Burton, *The Litigator: How Stanley Chesley Settles Things Quickly in Mass-Injury Suits: Class-Action Attorney Earns Big Fees in Settlements Some Say Are Premature,* WALL ST. JOURNAL, June 26, 1992, p. 1, col. 1.

The key element of the Delaware settlement industry is the ability of the purported class representative to release *all* claims, *including federal ones.* Otherwise the indulgence is not plenary; and if it is not plenary it will not command much of a price. Professor Coffee eloquently summarized the implications of this at the time of the first federal case to bless it, Judge Selya's opinion in *Nottingham Partners* v. *Trans-Lux Corp.,* 925 F.2d 29 (1st Cir. 1991):

> "[F]or the litigator, the most interesting recent development in securities litigation may be the appear-

ance of *a new technique by which a collusive settlement—that is, a non-adversarial settlement that maximizes the attorney's interest at the expense of the client's*—can be negotiated. . . . .

"Because the general release issued to the defendants in the state court settlement resulted in issue preclusion, the consequence was that no court, state or federal, could hear plaintiffs' claim of proxy fraud. The seeming paradox in *Nottingham Partners* is that a state court settlement can have preclusive effect despite the fact that the state court lacked subject matter jurisdiction over the claims thereby barred.

"While the legal issue of when one court has the power to approve the release of claims pending in another forum is complex, the practical message to plaintiffs' counsel is much simpler: *weak derivative and class action claims that once would have been routinely dismissed by the Delaware Chancery Court now have an enhanced settlement value, because they can confer immunity with respect to . . . federal securities class actions, which often would have a significant settlement value.*

"Ironically, the incentives for defendants are even clearer: never seek dismissal on the merits of a state class action if a companion federal class action raising related federal claims is possible, but instead reach a settlement in which the defendants are given a general release. If properly structured to fall within the *Nottingham Partners* precedent, such a release will preclude a federal class action raising federal securities claims.

"This type of settlement can be described as 'collusive' because the parties to the state court settlement are effectively depriving absent players—the plaintiffs and their attorneys in the federal action—

> of their day in court. The net result is effectively both a wealth transfer from the federal plaintiffs' attorneys to the state plaintiffs' attorneys and *a reduction in the total recovery to the class (because the state plaintiffs' attorneys are settling federal claims that they can never win, but can only settle, and should thus accept a lesser settlement than would the federal plaintiffs' attorneys*).
>
> "Although it is still premature to predict that Rule 10b-5 actions will become an endangered species, the possible end result of *Nottingham Partners* will be that the already well-traveled road to the Delaware courts could become a six-lane highway as plaintiffs and defendants rush to settle there before a federal court can stay them."

After pointing out that in the companion state case the Delaware Supreme Court had held that a non-opt-out class was permissible when the action primarily sought equitable relief, Professor Coffee observed:

> ". . .Delaware's approach poses a major hurdle for securities plaintiffs because it is easily manipulated.
>
> . . . .
>
> ". . . [E]ven plaintiffs who have filed an earlier action for monetary damages in federal court are in trouble, because a Delaware action can always be brought for injunctive relief and will predictably settle quickly in order to be used as a barrier to the federal action."

Coffee, *Suspect Settlements in Securities Litigation, supra* (emphasis added). Stated differently, the weaker, less developed, and more feebly pursued the state claim, the easier it will be to persuade the state judge to accede to a settlement and hence the easier it will be to use it to dispose of a federal claim.

It is the key element of such "collusion" and "manipulation" that is blessed by the decision below.

B. The Decision Below Is Replete With Errors of Law Which Involve Questions Which Have Not Been, But Should Be, Settled by This Court, And As to Several of Which There Are Conflicting Decisions in Other Circuits

We turn now to the propositions of law for which the decision below stands.

1. The Question of a State Court's Ability To Authorize Extinction of a Federal Claim Over Which It Has No Jurisdiction

Proposition 1, *supra,* is far and away the most important aspect of the case. It is wrong because of the Supremacy Clause. When Congress has conferred on Grimes and Holbrook a right under the federal securities laws, which Congress has said cannot be adjudicated in a state court, but only in a federal court before an Article III judge under federal procedure (including federal class action procedure) and with a Seventh Amendment jury, a Delaware chancery court has no power to take that right away from them through a non-opt-out class action or any other device.

It is perfectly true that "a state court has the power to enter a settlement negotiated *by the parties* as a judgment which releases exclusive federal claims that the state court could not itself entertain." App. 21a (emphasis added); see also App. 2a. But the key is "*by the parties.*" If Holbrook and Grimes or agents empowered by them had "negotiated" this release, of course it would bind them. But the release was agreed to not by them but by agents forced on them. As Judge Friendly pointed out in his characteristically perceptive analysis in *National Super Spuds, Inc.* v. *New York Mercantile Exchange,* 660 F.2d 9, 18-19 (2d Cir. 1980), the designation of a class repre-

sentative is simply the judicial appointment of an agent and the clothing of that agent with defined and limited powers. In the *opt-out* situation each of the individual class members in effect ratifies or repudiates the appointment. But when a court designates a *non-opt-out* class, it is compelling the class members to accept willy-nilly an agent clothed with whatever powers the court may confer on him.

So, when here the Delaware court certified strangers to Holbrook and Grimes as "representatives" of a non-opt-out class, it was purporting to constitute these strangers as their agents under its rules. Can Delaware assume the power to authorize it to apply those rules to *federal* claims over which the State has no authority? We believe that it cannot, under the Supremacy Clause.

A state court cannot do anything that interferes with a right of action in federal court, for "[t]he right to pursue federal remedies and take advantage of federal procedures and defenses in federal actions may [not] . . . be restricted by a state court . . . ." *General Atomic Co.* v. *Felder,* 434 U.S. 12, 18-19 (1977). The right of a federal-court litigant to pursue his right to federal-court remedies "was granted by Congress and cannot be taken away by the State." *Donovan* v. *Dallas,* 377 U.S. 408, 413-14 (1964).

Nor can a state's procedural rules—such as its class action rules—be allowed to impair a federal right. "The laws of the United States cannot be evaded by the forms of local practice." *American Railway Express Co.* v. *Levee,* 263 U.S. 19, 21 (1923) (Holmes, J.). "The States cannot, in the exercise of control over local laws and practice, vest State courts with power to violate the supreme law of the land." *Kalb* v. *Feuerstein,* 308 U.S. 433, 439 (1940).

A state can no more dispose of a person's federal claim over which it has no jurisdiction than it could interfere with any other property grant by the United States. "[A] chose in action is a constitutionally recognized property

interest . . . ." *Phillips Petroleum Co.* v. *Shutts,* 472 U.S. 797, 807 (1985). A damages claim under the federal securities laws is thus as much a property right conferred by the United States as is a grant of real property by the United States. And "[m]anifestly Congress is vested with the absolute right to designate the person to whom real property belonging to the United States shall be transferred, and to prescribe the conditions and mode of the transfer; and a state has no power to interfere with that right or to embarrass the exercise of it." *United States* v. *Board of Commissioners of Fremont County,* 145 F.2d 329, 330 (10th Cir. 1944), *cert. denied,* 323 U.S. 804 (1945).

The state of Delaware obviously could not itself assume the right to dispose of the class members' federal claims; and it cannot confer on a private individual (here, the purported class representative) the legally enforceable authority to do what it cannot do itself.

The situation is closely analogous to *Phillips Petroleum Co.* v. *Shutts, supra,* holding that where a plaintiff class member is outside the court's personal jurisdiction, due process will not permit the court to force upon him an agent empowered to deal with his claim. Identical considerations apply here, except that here the forum state's inability to force an agent upon the absent class members reflects not merely that they are out of its physical reach, but that the subject-matter of the purported agency is out of reach of the forum state's courts; and except that the governing constitutional provisions are the Supremacy Clause and basic notions of federalism.

The court of appeals decision that offers nearest support for the decision below is Judge Selya's opinion in *Notthingham Partners* v. *Trans-Lux Corp.,* 925 F.2d 29 (1st Cir. 1991) (discussed by Professor Coffee in the article excerpted *supra*). *Nottingham* in turn relied on language in *Abramson* v. *Pennwood Investment Corp.,* 392 F.2d 759, 762 (2d Cir. 1968), in which a general release in settlement

of a state court derivative action was held to bar a parallel federal securities action. But—as Judge Hutchinson pointed out in his dissent below, App. 39a n.11—*Abramson* was a *derivative* action, not a *representative* one. In a derivative action a stockholder sues to vindicate the corporation's claims, not his own. He brings the corporation itself before the court *as a party* and causes it to take action to protect its interests. In a representative action, by contrast, the plaintiff is asserting his own claims and those of non-parties with similar rights who are not before the court. Settlements in the two types of cases are thus completely different. In a derivative suit, as Judge Friendly pointed out in *National Super Spuds, supra,* "the legal entity whose unpleaded claims are being released—the corporation—is a party to the settlement. The corporation has the power to release its claims whether asserted in the complaint or not," 660 F.2d at 18-19, whereas in a representative suit there is no one with power to give a release of the class's rights in addition to the judgment. *Id.* at 18. *Abramson,* in other words, sheds no light on the effect of settlements negotiated by persons *other than the parties.* A party can obviously always release his own claim. This truism tells nothing about authority to release someone else's.

No other circuit opinion besides *Nottingham* has directly addressed the question. Several have considered the authority of a class representative in a *federal* action to release a *state* claim. Because of pendent jurisdiction, this is fundamentally different from the authority of a *state* court to deal with a *federal* claim *over which Congress has denied it jurisdiction,* although some of these opinions contain loose language which out of context might be claimed to support the decision below. (And some involve opt-out considerations; *cf.* the dissent below, App. 39a n.11.) *Class Plaintiffs* v. *City of Seattle,* 955 F.2d 1268, 1287-89 (9th Cir.), *cert. denied,* 121 L.Ed.2d 333 (1992); *TBK Partners, Inc.* v. *Western Union Corp.,* 675 F.2d 456 (2d Cir. 1982);

In Re Corrugated Container Antitrust Litigation, 643 F.2d 195 (5th Cir. 1981), *cert. denied*, 456 U.S. 998 (1982); *cf. In Re Real Estate Title and Settlement Services Litigation*, 869 F.2d 760 (3d Cir.), *cert. denied*, 493 U.S. 821 (1989). *In Re General Motors Corp. Engine Interchange Litigation*, 594 F.2d 1106 (7th Cir.), *cert. denied*, 444 U.S. 870 (1979), seems clearly contrary to *Nottingham* and the opinion below, saying that when a district court had declined to exercise pendent jurisdiction over state claims, it "was without power to extinguish them" in approving a settlement. 594 F.2d at 1134. The Seventh Circuit would doubtless *a fortiori* hold that a state court was without power to extinguish exclusively federal claims.

The operative factor, moreover, is the limit placed by Congress on the state court's *subject-matter* jurisdiction. The question has nothing to do with due process limits on *personal* jurisdiction. *It would make no difference if Grimes and Holbrook lived in downtown Wilmington; the Delaware court could still not authorize anyone to give away their federal rights.*

2. The Question Whether Mere Evaluation of a Possible Claim at a Settlement Hearing Can Constitutionally Be Deemed "Actual Litigation" of the Facts of the Claim, Resulting in Issue Preclusion

Proposition 2. The opinion below tries an end-run around the problem by treating it as one of personal jurisdiction and issue preclusion. It reasons that the state court had personal jurisdiction over Holbrook and Grimes; it could therefore force them into a non-opt-out class with respect to the state proceeding; Delaware courts would then regard them as precluded from litigating elsewhere any issue supposedly "litigated" in the settlement hearing, and under the Full Faith and Credit Act, 28 U.S.C. § 1738 (federal courts must give the same effect to state court judgments as the state court would), as refined in *Marrese*

v. *American Academy of Orthopaedic Surgeons,* 470 U.S. 373 (1985), they were likewise so precluded in this case.

The plain error in this argument is that the Full Faith and Credit Act itself necessarily incorporates constitutional due process limitations on the preclusive effect a state court can give to a judgment. *Kremer* v. *Chemical Construction Corp.,* 456 U.S. 461, 482-83 (1982). And Delaware could not constitutionally preclude any issues in a disclosure case as having been "litigated" based on what transpired at the settlement hearing. (Nor in fact would Delaware do so; we believe that the court below, with respect, distorted Delaware preclusion law to reach its decision here.) For a person to be deprived of a claim on the ground of issue preclusion, due process demands that the issue have been *actually litigated* and *actually decided,* and have been *necessary* to the decision. RESTATEMENT, JUDGMENTS 2D § 27.

"Actually litigated" in this context means that the issue is "properly raised, by the pleadings or otherwise, and is submitted for determination, and is actually determined." RESTATEMENT, JUDGMENTS 2D § 27 Comment *d.* Moreover, due process demands full opportunity to present evidence and rebut opposing evidence with respect to the issue sought to be precluded. *Kremer, supra,* at 483-84. Nothing of the sort happened or could have happened in the settlement hearings. Disclosure claims came up solely in the context that Grimes argued that they existed and were too valuable to be given up for a derisory consideration. The issues underlying the present claim are such matters as whether material information was withheld, *scienter,* and the like. *Nothing* of this kind was either "submitted for determination" or "actually determined" at the settlement hearing. At such a hearing—

> "[t]he court is concerned only with the *likelihood* of success or failure; the actual merits of the controversy are not to be determined. The evidence is limited

> accordingly. The rules of evidence are relaxed. The court listens to the advice and wishes of interested parties. This is not the procedural stuff from which binding determinations of fact can be drawn."

Haudek, *The Settlement and Dismissal of Stockholders' Actions*, 23 Sw. L.J. 765, 809 (1969) (emphasis original) (footnotes omitted). The full description of the proceedings at App. 54a, 59a-85a, confirms that the settlement hearing here was of this nature. The state court was explicit that "*it is not necessary for the Court to decide the merits of the case.*" App. 60a (emphasis added). Moreover, since the "predicate facts" in the two cases have little or no overlap other than the general background of the tender offer, Table 1, App. 122a, even if the state case had been in truth "litigated," the disclosure issues relevant here would have been unnecessary to a decision and neither tried nor decided.

With respect, it is truly astonishing that the court below could have considered that by objecting at the settlement hearing Grimes "actually litigated" state law "disclosure claims" whose "predicate facts" "overlap significantly" with the "predicate facts" underlying this federal securities law claim. App. 7a. For it to say that the state courts "rejected Mr. Grimes' disclosure claims," App. 10a; that "Grimes pursue[d] the . . . disclosure claims through the Delaware court system," App. 10a; that "the facts that underlie the federal non-disclosure claims were *actually litigated* during the state court proceeding and were *conclusively resolved* against the objectors," App. 17a (emphasis added), and similar statements, is simply inexplicable.

Due process will not permit Grimes to be deprived of a substantial claim by characterizing the settlement hearing's general discussion and overall appraisal as "actual litigation" by him of the "underlying facts."

3. Other Class Action Questions, Including Personal Jurisdiction, Scope of Representation, Collateral Attack, and Minimum Standards for Settlement Approval

Proposition 3. The discussion of Proposition 2 applies only to Grimes, for Holbrook never appeared at the hearing and can have "litigated" nothing. The court below held *him* bound by the release on the ground that he had "minimum contacts" with Delaware. "An appropriate basis for the Delaware court's power to bind non-resident shareholders in such a proceeding," it said (without authority, analysis, or explanation), "is ownership of Vitalink stock together with any other activity engaged in by the members of the class pursuant to their shareholder rights." App. 12a-13a. This is inconsistent with *Shaffer* v. *Heitner*, 433 U.S. 186 (1977), holding that even being a stockholder *and an active officer or director* in a Delaware corporation is not a "minimum contact." Moreover, the opinion's gropings for some such "any other activity" are, with respect, unintelligible. Without going into the tangled detail, we note that Holbrook tendered his stock (in New York, *not* in Delaware) *before* the tender offer closed on June 20 and hence his tender could not have been in response to either the July 11 letter or the July 29 notice (at different places the opinion below says both: App. 5a, 13a, 15a). The opinion thrice refers, without elucidation, to tender of shares "*to* the Delaware corporation." App. 2a (emphasis added), App. 13a, App. 14a n.7. It twice says Holbrook tendered in response to "the proxy mailing" or "a proxy offer," App. 2a, 16a, yet *there was no proxy involved anywhere in the transaction.* In any case, how can the sale of stock in New York, whether or not with knowledge of a pending class action settlement, constitute "purposeful availment" of any privilege or protection of Delaware law? See Judge Hutchinson's dissent below, App. 26a-27a.

The opinion on this point is fraught with mischief as a precedent and the governing standards need to be clarified by this Court.

Proposition 4. Allowing a non-opt-out class representative to bind class members in an action at law for damages is inconsistent with *Brown* v. *Ticor Title Ins. Co.*, 982 F.2d 386 (9th Cir. 1992), *cert. dismissed as improvidently granted*, 128 L.Ed.2d 33 (1994). The question remains certworthy.

Proposition 5. The decision below gives effect to a release of the (federal) *disclosure* action given by a class representative who was appointed with respect to the very different (state) *fiduciary duty* action. This is contrary to the leading case, *National Super Spuds, Inc.* v. *New York Mercantile Exchange*, 660 F.2d 9 (2d Cir. 1980), already cited *supra*, in which Judge Friendly held that a class representative's agency powers are measured by the class complaint, and that "[h]aving received authority to represent class members solely with respect to" the subject-matter of the complaint—in that case, certain contracts—such a representative "had no power to release any claims based on any other contracts." *Id.* at 18. He added a footnote that exactly fits the situation here:

> "We assume that a settlement could properly be framed so as to prevent class members from subsequently asserting claims relying on a legal theory different from that relied upon in the class action complaint but depending upon the very same set of facts. *This is not such a case.* The settlement before us [which the opinion rejected] would bar Richards [or, here, Grimes and Holbrook] and others similarly situated from asserting claims, distinct from those represented by the class action plaintiffs, which depend *not only upon a different legal theory but upon proof of further facts*, namely, the holding of unliqui-

> dated contracts after May 7, wrongful default on those contracts, and the damages caused by the default [or, here, the withholding of material information, *scienter,* sale of stock in reliance, and damages caused]."

Id. at 18 n.7 (emphasis added).

The court below could deal with this only by baldly asserting that the instant action depends on the "very same set of facts" as did the state action. App. 22a. That is egregiously incorrect. See Table 1, App. 122a.

(Incidentally, Judge Friendly's reference to "claims relying on a [different] legal theory but depending upon the very same set of facts" was not made in the context of legal theories over which the court was without jurisdiction.)

Propositions 6 and 7. As described *supra,* the Delaware court ignored a cluster of indicia of a sham settlement. We submit that in a proposed class settlement there can be no "informed and independent judgment" as to adequacy of representation if the judge does not "apprise[] himself of all facts necessary for an intelligent and objective opinion." *Protective Committee* v. *Anderson,* 390 U.S. 414, 424 (1968). We submit that, at least where, as here, there are circumstances that would place a reasonable person on inquiry, due process requires the court to develop an evidentiary record from which adequacy of representation can fairly be appraised, and to show that it has given that record due consideration, before purporting to cut off forever the rights of class members. Since most class actions are settled, guidance from this Court on this point is needed to flesh out the *substantive* principle of *Hansberry* v. *Lee,* 311 U.S. 32 (1940), by defining the *procedural* minimum that a court must undertake to satisfy itself that the class is adequately represented. (This is the point on which Grimes sought certiorari two years ago. Denial of course was not an adjudication and does not preclude seeking it now.)

The court below held that Grimes and Holbrook could not "relitigate [*sic*] the factual issues of . . . adequacy of representation, and fairness of the settlement." App. 20a, 10a. Holbrook, of course, has never "litigated" anything and hence does not seek to "relitigate" anything. Under black-letter law, he *cannot* be foreclosed from contending here that due process was not accorded in the settlement hearing. "[C]ollateral attacks [are] a necessary part of the class action scheme," and are "integral to the constitutionality of the class action procedure." *In Re Real Estate Title and Settlement Services Litigation*, 869 F.2d 760, 769 (3d Cir.), *cert. denied*, 493 U.S. 821 (1989); *Hansberry* v. *Lee*, 311 U.S. 32 (1940); see *Martin* v. *Wilks*, 490 U.S. 775 (1989). Nor has Grimes "litigated" the question he raises under this proposition, *which is not the merits of the question of fair representation but rather whether he was given a full and fair chance to litigate that issue.* If he was not, he cannot be foreclosed now. *Kremer, supra.*

IV. CONCLUSION

The class action device—meant to *help* plaintiffs, not to *hurt* them—has gone off the rails. In particular, the "Delaware settlement" is an embarrassment to the law that should be dealt with by this Court. Its key is the notion that a state court to which Congress has denied any power over federal securities law claims can nevertheless force upon the holder of such a claim an agent authorized to sell it. This Court should confirm that this is unacceptable under the Supremacy Clause.

The efforts of the opinion below to circumvent that question are equally unacceptable. It offends due process to block a federal claim by issue preclusion not on the basis of true litigation and adjudication of the issues but merely because the claim was generally examined in a state court hearing on the settlement of other claims. It offends due process to allow a non-opt-out class representative, certified with respect to claims based on one set of facts, to

release claims based on different facts. It offends due process to allow a non-opt-out equity class representative to release claims for money damages at law. The holding that Holbrook had "minimum contacts" with Delaware offends due process and is fraught with enormous mischief for future cases. Finally, it offends due process to deny petitioners a fair opportunity to show that they were not fairly and adequately represented in the state class action.

The petition for certiorari should be granted.

Respectfully submitted,

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June 29, 1994

APPENDIX A

The Opinion Below

Filed March 9, 1994

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

NO. 93-1268

C.L. GRIMES and G.W. HOLBROOK, on their own behalf and on behalf of all persons similarly situated,

Appellants

v.

VITALINK COMMUNICATIONS CORPORATION; NETWORK SYSTEMS CORPORATION; LESLIE G. DENEND; J. DANIEL McCRANIE; CHARLES J. ABBE; HARRY T. REIN; LYLE D. ALTMAN

On Appeal from the United States District Court
for the Eastern District of Pennsylvania
(D.C. Civil No. 92-02722)

Argued October 8, 1993

Before: HUTCHINSON, COWEN and NYGAARD
Circuit Judges.

(Filed March 9, 1994)

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OPINION OF THE COURT

COWEN, *Circuit Judge.*

This case presents the question whether a state court has the power to allow parties as part of a comprehensive court-approved settlement to release exclusive federal securities law claims arising from the same transaction or occurrence as the state law matters before it, even though the state court would not have jurisdiction to hear the federal claims in the first instance. A subsidiary issue presented is whether a non-resident owner of corporate stock who tendered his shares to the Delaware corporation in response to a proxy offer following a merger transaction had sufficient minimum contacts to be bound by the settlement and release entered into on behalf of the plaintiff class of shareholders by a Delaware state court. Answering both questions in the affirmative, we will affirm the district court.

I.

The complicated background giving rise to this lawsuit in federal court started with a merger agreement between two

Delaware corporations. Vitalink Communications Corporation ("Vitalink") was a manufacturer of computer internetworking products known as wide area bridges. Network Systems Corporation ("Network"), a manufacturer of data communications equipment which connects mainframe computers, minicomputers, and computer networks, entered into a merger agreement on May 6, 1991, by which it would acquire the stock of Vitalink. It is not necessary for purposes of this opinion to lay out precisely the intricate details of the merger negotiations and the final agreement, other than to note that Network ultimately agreed to pay $10.50 in cash for each share of outstanding Vitalink stock.

On May 13, 1991, Leslie G. Denend, President of Vitalink, sent a letter to all stockholders stating that the Vitalink Board of Directors had unanimously approved the merger, indicating that the Board of Directors believed the terms of the merger were fair, and recommending that the stockholders accept the offer. The plaintiffs in this action, C.L. Grimes, a Pennsylvania resident, and G.W. Holbrook, a Connecticut resident, were among the Vitalink stockholders.

Shortly after the merger agreement was announced seven state law actions were commenced, four in Delaware and three in California. The plaintiffs in these cases alleged that the Vitalink defendants breached their fiduciary duties and that the Network defendants aided and abetted the Vitalink defendants in doing so. The Delaware cases were consolidated and the parties engaged in expedited discovery. Within several days of commencing discovery, the parties agreed to a settlement. The California and Delaware plaintiffs entered into a Stipulation and Agreement of Compromise, Settlement and Release on June 13, 1991. They agreed to settle the dispute and release all claims arising from the merger transaction[1] in exchange for

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1. The language of the settlement and release agreement, which is vital to the disposition of this case, is set out in full below:

> NOW, THEREFORE, IT IS STIPULATED AND AGREED, subject to the approval of the Court of Chancery, pursuant to Rule 23 of the

a ten-day extension of the merger offer, a reduction in the amount payable to Network under a stock option agreement if a third party made an offer for Vitalink, and for an amendment limiting the reimbursement of Network's fees by Vitalink in the event the merger agreement was terminated. In addition, the defendants agreed not to oppose an application by plaintiffs' counsel for an award of attorneys' fees not to exceed $275,000, and expenses not greater than $25,000.

The merger was completed on July 1, 1991, when Vitalink became a wholly owned subsidiary of Network. Vitalink shares that were not tendered were converted into

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> Rules of the Court of Chancery, that the Consolidated Action shall be dismissed on the merits with prejudice as to all the defendants and the Defendants' Affiliates ... and against the plaintiffs and all other members of the Class without costs, except as provided in the Stipulation. All claims, rights, causes of action, suits, matters and issues, known or unknown, that arise now or hereafter out of, or that relate to, or that are, were or could have been asserted in connection with, Vitalink's and N[etwork's] employment agreements, change of control agreements, stock arrangements, and similar arrangements with Vitalink's employees, the Stock Option Agreement, N[etwork's] proposals to acquire Vitalink's stock ..., the disclosures made in the Schedule 14D-9, the Offer and the Merger, or any matters, transactions or occurrences referred to in the Complaint, or any other complaint in the Consolidated Action, or in any complaint in the California Actions, or any public statements, announcements or other activities relating to any of the foregoing, or the Settlement ..., by any member of the Class or by Vitalink, either directly, individually, derivatively, representatively or in any other capacity against any of the defendants in the Consolidated Action, their respective present or former officers, directors, stockholders, agents, employees, attorneys, representatives, advisors, investment bankers ..., commercial bankers, accountants, insurers, trustees, parents, affiliates, subsidiaries ..., directors and officers of such parents, affiliates and subsidiaries, general and limited partners, heirs, executors, personal representatives, estates, administrators, successors and assigns ... shall be compromised, settled, released and discharged subject to [certain terms and conditions summarized in the text].

App. at 41-43 (capitalization in original).

the right to receive $10.50 per share or to seek appraisal. A notice of the completed merger was sent by Vitalink to all shareholders on July 11, 1991. In that letter, stockholders were given the option of surrendering their shares to the paying agent in exchange for $10.50 in cash per share, or to seek appraisal of the shares pursuant to Delaware corporation law. Mr. Holbrook tendered his shares in response to the letter from Vitalink, while Mr. Grimes did not do so.

On July 18, 1991, the Delaware Court of Chancery certified the Vitalink stockholders as a non-opt-out settlement class pursuant to Court of Chancery Rule 23(b)(1) and (2).[2] This class, consisting of all persons who owned Vitalink common stock between May 6, 1991 and July 1, 1991, included plaintiffs Grimes and Holbrook. A notification letter was sent to all class members discussing the pending class action litigation, describing the settlement benefits to the class, indicating that all class members had an opportunity to oppose settlement, and notifying the class of the date of the settlement hearing. Upon receiving written notice, a group of stockholders including Grimes filed objections to the settlement and presented argument at the subsequent hearing. Mr. Grimes and the other objectors argued that the interests of the stockholders were not adequately represented by the class representatives and that the settlement agreement did not result in any material benefits for the class. Mr. Holbrook did not enter an appearance in the Delaware state court proceedings and never opposed settlement of the class action claims.

The Delaware Court of Chancery approved the settlement by memorandum opinion issued on November 8, 1991. *See In re Vitalink Communications Corp. Shareholders Litig.*, [1991-92 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,585 (Del. Ch. Nov. 8, 1991). Mr. Grimes and the other objectors appealed this decision to the Delaware Supreme Court, which affirmed the Court of Chancery in an unpublished disposition without opinion. *See Grimes v. John P.*

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2. This rule is virtually identical to Federal Rule of Civil Procedure 23(b)(1) and (2).

McCarthy Profit Sharing Plan, 610 A.2d 725 (Del. 1992) (table). In a petition for certiorari, Mr. Grimes argued that the Delaware court proceedings violated due process because the court did not develop a sufficient record to consider whether absent class members were adequately represented. The Supreme Court denied this petition on October 5, 1992. *Grimes v. John P. McCarthy Profit Sharing Plan*, ___ U.S. ___, 113 S. Ct. 179 (1992).

Prior to the disposition of the writ of certiorari, Grimes and Holbrook filed the present action in the U.S. District Court for the Eastern District of Pennsylvania. In this case, the plaintiffs alleged that the defendants violated their duty of disclosure pursuant to sections 10(b) and 14(e) of the Securities Exchange Act of 1934. *See* 15 U.S.C. §§ 78j & 78n(e) (1988). Federal courts have exclusive jurisdiction over suits alleging violations of these securities law provisions. 15 U.S.C. § 78aa (1988);[3] *Cramer v. General Tel. & Elecs. Corp.*, 582 F.2d 259, 270 n.15 (3d Cir. 1978), *cert. denied*, 439 U.S. 1129, 99 S. Ct. 1048 (1979). In addition, the plaintiffs complained that the procedures employed by the state courts in resolving the Delaware action denied them due process of law.

Vitalink, Network, and the other defendants moved the district court to dismiss the federal action based on the judgment in the Delaware action. In essence, they argued that the state court approved a release of all claims arising from the merger, including exclusive federal claims, and that the federal court was required to adhere to that judgment consistent with full faith and credit.[4] Grimes and

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3. Title 15 U.S.C. § 78aa provides in relevant part that "[t]he district courts of the United States ... shall have *exclusive jurisdiction* of violations of this chapter ..., and of all suits in equity and actions at law brought to enforce any liability or duty created by this chapter." *Id.* (emphasis added).

4. "Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State." U.S. Const. art. IV, § 1. Congress has extended the reach of the Full Faith and Credit Clause to require federal courts to uphold the judgments of state courts. 28 U.S.C. § 1738 (1988). The full faith and credit statute provides that state court judgments "shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken." *Id.*

Holbrook opposed dismissal of their suit and requested the district court to treat the motion as one for summary judgment. Likewise, they moved the district court for partial summary judgment and submitted several supporting documents to the court.

In a memorandum opinion dated February 27, 1993, the district court denied plaintiffs' partial motion for summary judgment and granted defendants' motion for summary judgment. *Grimes v. Vitalink Communications Corp.*, No. 92-2722, 1993 WL 56032 (E.D. Pa. Feb. 27, 1993). The district court ruled that the legal doctrines of collateral estoppel and release bar the federal court from considering the alleged violations of federal securities law stemming from the merger. *Id.* at *2-5. First, the district court found that the plaintiffs in this case were members of the non-opt-out state court class who were bound by the broad release approved by the Delaware Court of Chancery. *Id.* at *2-4. Second, and alternatively, the district court held that this federal securities case is barred by the collateral estoppel effect of the Delaware judgment because the predicate facts that underlie the federal case, which primarily involve issues of nondisclosure, overlap significantly with facts conclusively established in the state court proceeding. *Id.* at *4-5. Finally, the district court also examined the federal plaintiffs' allegation that they were denied due process in the state court proceedings and concluded that this claim was not meritorious. *Id.* at *5-6.

II.

The district court had jurisdiction over this case pursuant to section 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa. By granting the defendants' motion for summary judgment, the district court ordered the case dismissed. We have appellate jurisdiction pursuant to 28 U.S.C. § 1291 as plaintiffs have appealed a final judgment of dismissal.

The district court's grant of summary judgment in favor of defendants is subject to plenary review. *Wheeler v. Towanda Area School Dist.*, 950 F.2d 128, 129 (3d Cir. 1991); *American Medical Imaging Corp. v. St. Paul Fire and*

Marine Ins. Co., 949 F.2d 690, 692 (3d Cir. 1991). To the extent the district court interpreted and applied Delaware law, the district court is not entitled to deference. The determinations regarding state law, where appropriate, will be reviewed de novo. *Salve Regine College v. Russell*, 499 U.S. 225, __, 111 S. Ct. 1217, 1221 (1991); *Borse v. Piece Goods Shop, Inc.*, 963 F.2d 611, 613 (3d Cir. 1992).

III.

A.

The central issue raised in this appeal is whether a state court, which does not have subject matter jurisdiction to hear exclusive federal claims, may nevertheless approve a settlement and release of those claims by the parties. The plaintiffs urge this court to adhere to the view that the Delaware release does not extinguish the exclusive federal claims because Congress did not authorize Delaware or other state courts to hear such claims in the first instance. As a starting point, however, it is important to emphasize that the Delaware court did not purport to exercise any inherent power to release causes of action that it had no jurisdiction to entertain. Rather, the Delaware court only acted to enter a settlement agreement that was initiated, negotiated, and adopted by the parties to a lawsuit that was properly before it.

It is significant to note that a release may take one of at least two distinct forms. In the first situation, a release may be entered into by parties engaged in a colorable legal dispute for which no formal complaint has been filed. The parties may negotiate a settlement of the dispute and in the process execute a release of all claims. The release acts as a simple contract between two private parties not engaged in a lawsuit. If one of the parties later breaches that contract by filing a complaint stemming from the relevant transaction, then the defendant may present the release as a defense to the lawsuit and argue that the claims alleged in court were contracted away by the plaintiff. Assuming that there is no relevant exception to the release defense, for instance that the release was only entered into on the

basis of deception or coercion, *see In re Complaint of Bankers Trust Co.*, 752 F.2d 874, 885 (3d Cir. 1984), then the contract should be given full preclusive effect by the court.

In the second situation, which encompasses the case *sub judice*, a lawsuit has been commenced by one party asserting claims against the other. When the parties in a pending case negotiate a settlement, the resulting court order dismissing the case is a final judgment in that lawsuit. As a judgment, the settlement and release of claims is a contract that not only is agreed upon by the parties, but also is stamped with the imprimatur of the court with jurisdiction over the parties and the subject matter of the lawsuit. *See Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29, 33 n.2 (1st Cir. 1991). Thus, the release is not simply a contract entered into by private parties, but is one that has been given a stamp of approval by the court.

When the underlying legal dispute is a class action, as is the present case, then the court has more than a ministerial duty to enter the negotiated settlement and release as a judgment. In this circumstance, the court has an elevated duty to ensure that the settlement is fair and adequate to all the plaintiff class members, not just the named representatives who negotiated its substantive terms. This duty is particularly acute when the class action is one certified under Federal Rules of Civil Procedure 23(b)(1) or (2), or their state counterparts, because the class members have been denied an opportunity to opt out of the putative class. In effect, all ordinary class members are bound by the deal struck by their named representatives in the event the court determines that they were adequately and fairly represented during the course of the negotiations.

That is not to say, however, that non-representative class members are without recourse in the event that they do not feel the negotiated settlement and release is in their individual or the class' best interest. When this fairly usual circumstance arises, the objecting class members must be given an opportunity to address the court as to the reasons the proposed settlement is unfair or inadequate. The court

then rules as to the adequacy and fairness of the settlement. *See, e.g., Girsh v. Jepson*, 521 F.2d 153, 156-57 (3d Cir. 1975) (discussing the factors a trial court should utilize when determining the fairness of a class action settlement for absent members of the plaintiff class).

As the district court noted, *Grimes*, No. 92-2272, 1993 WL 56032, at *3, the federal plaintiffs pursuing this case on appeal were provided with such an opportunity in the state court litigation. As the district court stated:

> The plaintiffs, as class members, received notice of the Delaware proceedings and were provided an opportunity to be heard. Indeed, plaintiff Grimes vigorously exercised this opportunity. Both the Delaware Chancery Court and the Delaware Supreme Court rejected Mr. Grimes' disclosure claims and found the settlement to be fair to the Vitalink stockholders.

Id. (citing the Delaware court dispositions); *see also In re Vitalink*, [1991-92 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,585, at 92,743-45 (Del. Ch. Nov. 8, 1991). Not only did plaintiff Grimes pursue the adequacy of representation and disclosure claims through the Delaware court system to its highest court, but when relief was denied he petitioned the United States Supreme Court to hear the case. When the Supreme Court declined to disturb the decision of the Delaware Supreme Court, *see Grimes*, __ U.S. at __, 113 S. Ct. at 179, he and the other class members had been granted all the process that was due. The members of the class, including Holbrook and Grimes, were provided an opportunity to be heard, actually litigated, and lost on the issue of whether they were deprived due process in the state court proceeding.

The plaintiffs' attempt to relitigate the issue of whether they were adequately represented during the settlement negotiations and whether the state court considered sufficient evidence to make its determination is even less compelling than that of the federal plaintiffs in *Nottingham Partners*, the most analogous case on point. In *Nottingham Partners*, the plaintiffs filed suit in federal court "in vain pursuit of back-door relief" without even appealing the state court adjudication to the United States Supreme Court. 925

F.2d at 33. Here, the objectors pursued their direct appeal all the way to the Supreme Court without obtaining relief.

B.

Although plaintiffs concede they pursued the adequacy of representation issue on appeal through the Delaware court system, they argue that such process cannot bind non-resident, non-objecting class members like Holbrook who never entered an appearance during the pendency of the Delaware litigation.[5] Plaintiffs would even take this argument one step further to assert that the Delaware judgment does not bind Holbrook because he did not formally consent to personal jurisdiction in the Delaware court and because he does not have "minimum contacts" with this forum for purposes of this adjudication. *See International Shoe Co. v. Washington*, 326 U.S. 310, 316, 66 S. Ct. 154, 158 (1945).

Although the class members in the present case were not provided with an opportunity to opt out, the state court had the requisite power to bind absent class members as long as they had minimum contacts with the forum and they were not otherwise denied due process. *See id.* at 317-18, 66 S. Ct. at 159 (minimum contacts in and of themselves suffice for specific jurisdiction). We first consider whether Holbrook had sufficient minimum contacts with the Delaware forum to be bound by its judgment. Addressing this issue, a Delaware court has held that it may exercise *in personam* jurisdiction over absent members of a plaintiff class who have not been provided an opportunity to opt out based solely on the fact of ownership of Delaware corporate stock. *Hynson v. Drummond Coal Co.*, 601 A.2d 570, 575-79 (Del. Ch. 1991). In *Hynson*, Chancellor Allen stated that:

> It is not unreasonable—not inconsistent with traditional notions of fairness . . . —to conclude that the law has long put the buyer of corporate stock on notice that corporate rights attaching to stock

5. Plaintiff Grimes does not contest that the Delaware Court of Chancery had personal jurisdiction over him as he appeared at the settlement hearing to litigate his objections.

> ownership may be adjudicated in a single proceeding in another jurisdiction, including at a minimum the corporation's state of incorporation.

Id. at 579 (citing *Shaffer v. Heitner*, 433 U.S. 186, 219-28, 97 S. Ct. 2569, 2588-92 (1977) (Brennan, J., concurring in part and dissenting in part)). Such an exercise of personal jurisdiction is inherently limited to adjudication of rights associated with ownership of that stock. *Id.* Thus, stock ownership alone suffices for "specific jurisdiction" but not "general jurisdiction."

We have long recognized an important distinction between basing personal jurisdiction in a particular forum on contacts that are unrelated to the claim being adjudicated (general jurisdiction), as opposed to basing personal jurisdiction on contacts directly related to the claim or claims at issue (specific jurisdiction). *E.g., Dollar Sav. Bank v. First Security Bank of Utah*, 746 F.2d 208, 211 (3d Cir. 1984); *Compagnie des Bauxites de Guinea v. Insurance Co. of N. Am.*, 651 F.2d 877, 889 (3d Cir. 1981) (Gibbons, J., dissenting in part) ("Specific and general jurisdiction analyses are quite distinct."), *aff'd sub nom. Insurance Corp. of Ireland, Ltd. v. Compagnie des Bauxites de Guinea*, 456 U.S. 694, 102 S. Ct. 2099 (1982). Unlike establishing general jurisdiction where the party must be shown to have "maintained continuous and substantial forum affiliations," *Dollar Sav. Bank*, 746 F.2d at 212, establishing specific jurisdiction, at a minimum, requires only that a party be shown to have committed at least one act in the relevant forum which is substantially related to the claim being adjudicated, *see Carteret Sav. Bank, FA v. Shushan*, 954 F.2d 141, 146-48 (3d Cir.), *cert. denied*, ___ U.S. ___, 113 S. Ct. 61 (1992). The claims adjudicated in the Delaware Court of Chancery involved the duties of care and disclosure exercised by the members of the Vitalink Board of Directors in accepting Network's merger offer, as well as the fairness and adequacy of representation by the class representatives. An appropriate basis for the Delaware court's power to bind non-resident shareholders in such a proceeding is ownership of Vitalink stock[6] together with any

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6. The state of Delaware is the situs of ownership of all stock in Delaware corporations. Del. Code Ann. tit. 8, § 169 (1991).

other activity engaged in by the members of the class pursuant to their shareholder rights. Thus, in this collateral attack we are concerned with whether the Delaware Court of Chancery had specific jurisdiction to bind non-resident members of the plaintiff class like Holbrook.

In the present case, plaintiff Holbrook and all other class members owned stock in Vitalink, a Delaware corporation. Nevertheless, we need not decide whether the single act of purchasing and owning stock in a Delaware corporation would provide sufficient contacts for the state court to exercise specific jurisdiction over every member of the class because the record discloses that Holbrook had an important further contact with the Delaware forum. By surrendering his shares in response to the tender offer with knowledge of his status as a member of the plaintiff class in a pending class action lawsuit containing all the attendant procedural protections designed to ensure that only a fair and adequate settlement judgment would be entered by the court, Holbrook purposefully availed himself of the privilege of having the Delaware Court of Chancery finally, and in a single lawsuit, determine the adequacy of the settlement agreement, "thus invoking the benefits and protections of its laws." *Hanson v. Denckla*, 357 U.S. 235, 253, 78 S. Ct. 1228, 1240 (1958).

Prior to class certification, each member, including Holbrook, was provided with notice that the Vitalink Board had accepted a merger offer from Network that would provide a cash payment of $10.50 per share. This notice was followed by a letter from the Delaware Court of Chancery discussing the pendency of the class action litigation, describing the terms of the settlement agreement, and indicating that every class member had the right to oppose the settlement at a formal hearing. In response to these notifications, Holbrook elected to tender his shares to the Delaware corporation in exchange for the merger price. This affirmative act provided an important further contact with the Delaware forum. Based on his ownership of stock in Vitalink, a Delaware corporation, and his additional act of tendering his shares, we conclude that Holbrook had sufficient contacts with Delaware for its courts to exercise

in personam jurisdiction for the limited purpose of determining the fairness of the settlement with respect to his stock ownership rights.[7]

Turning to the issue of the adequacy of process, the Supreme Court in a related context has indicated that the due process protections required for out-of-state class plaintiffs are significantly lower than those needed for defendants. *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797, 808-11, 105 S. Ct. 2965, 2972-74 (1985). Plaintiffs require fewer due process protections because there are inherent protections built into the class action device and because they are subjected to lesser burdens than defendants. *Id.* at 809-11, 105 S. Ct. at 2973-74. Thus, the Delaware state court need only have provided "notice plus an opportunity to be heard and participate in the litigation" in order to satisfy due process.[8] *Id.* at 812, 105 S. Ct. at 2974.

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7. We need not articulate whether we agree or disagree with most of what Judge Hutchinson has written in dissent because his opinion focuses on an issue that is beyond the scope of this case, namely whether it is constitutional for a court to bind a non-resident, non-consenting member of a non-opt-out class who has insufficient contacts with the forum. In light of our analysis as set forth above, we hold that Holbrook had sufficient contacts with the Delaware forum to be bound by the settlement agreement and judgment entered into on behalf of the class plaintiffs by the Delaware Court of Chancery. In addressing this holding, Judge Hutchinson expresses without analysis that he fails to see why Holbrook's affirmative act of tendering his shares to the Delaware corporation provides a further, sufficient contact with the Delaware forum so that the Court of Chancery could exercise specific jurisdiction over him.

8. We recognize that in *Shutts* the Supreme Court addressed the minimal due process requirements to bind absent members of a plaintiff class who had an opportunity to opt out. *Id.* at 812, 105 S. Ct. at 2974. The Court described the class action device as one that protects the interests of absent plaintiffs through court inquiry into the common nature of all claims, the adequacy of representation, proper jurisdiction over the class, as well as a judicial determination of the fairness and adequacy of any proposed settlement agreed upon by the parties. *Id.* at 809-10, S. Ct. at 2973. Although the present case involves a class action in which the absent plaintiffs were not given the additional procedural protection of an opportunity to opt out, we conclude that the due process protections as articulated in *Shutts* are sufficient to bind absent class members who had sufficient minimum contacts with the forum.

The Delaware Court of Chancery sent by mail to each class member, including Holbrook, written notice of the pendency of the class action containing a full disclosure of the proposed settlement and its ramifications.[9] This disclosure statement also notified all class members that a hearing to determine the fairness and reasonableness of the settlement had been scheduled for September 16, 1991 before the Delaware Court of Chancery. The class members were invited to appear at the hearing to "present any evidence or arguments that may be proper and relevant" concerning the settlement upon providing ten days written notice of their intent to appear. App. at 535. Despite receiving written notice and an opportunity to challenge the settlement, Holbrook made a conscious choice to accept the tender offer price of $10.50 per share without objecting. Although the present class members were not provided with an opportunity to opt out of the class, we conclude that the Delaware Court of Chancery provided sufficient due process protections to bind absent class members like Holbrook who failed to appear and object to the settlement.

The plaintiffs contend that *In re Real Estate Title & Settlement Servs. Antitrust Litig.*, 869 F.2d 760, 762 (3d Cir.), *cert. denied sub nom. Chicago Title Ins. Co. v. Tucson Unified School Dist.*, 493 U.S. 821, 110 S. Ct. 77 (1989), provides support for the proposition that the state court could not release Holbrook's federal claims because it did not have personal jurisdiction to bind him. We agree with the district court, *see Grimes*, No. 92-2722, 1993 WL

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9. The class notice contained a section entitled **"DISMISSAL OF THE CONSOLIDATED ACTION AND RELEASE OF CLAIMS."** App. at 533-34 (emphasis in original). This section stated in relevant part:

> All claims, rights, causes of action, suits, matters and issues, known or unknown, that arise now or hereafter out of, or that relate to, or that are, were or could have been asserted in connection with . . . N[etwork's] proposals to acquire Vitalink stock . . . . the disclosures made in the Schedule 14D-9, the Offer and the Merger, ... by any member of the Class . . . shall be compromised, settled, released and discharged.

Id. Holbrook does not contend that he failed to receive this written notification.

56032, at *3, that this reading of *Real Estate Title* is mistaken.

If at all relevant to this case, *Real Estate Title* stands only for the limited principle that "an absent class member can[not] be *enjoined* from relitigation if the member does not have minimum contacts with the forum" or consent to jurisdiction. 869 F.2d at 769 (emphasis in original). The present case does not involve a suit brought by the merging corporations to enjoin the federal plaintiffs from relitigating any claims or issues. Rather, the defendants have only raised the state court release as a defense—it is a judgment that precludes relitigation of all claims that were released by the parties. More importantly, we have already concluded that Holbrook had sufficient contacts with Delaware to be bound by the judgment of the Court of Chancery concerning his Vitalink stock ownership rights. Therefore, *Real Estate Title* does not change our analysis of the personal jurisdiction issue.

We therefore conclude that the Delaware court had *in personam* jurisdiction over the class members, including Holbrook, who tendered their shares in response to the proxy mailing and who did not make an appearance at the hearing to voice objections to the adequacy of the negotiated settlement. Both Grimes and Holbrook were provided sufficient process by the Delaware court system to challenge the settlement. Despite the objections actually lodged, the settlement and release were approved by the Delaware court and thereby bind all who were parties to the lawsuit. As members of the plaintiff class, Grimes and Holbrook are bound by the terms of the release that was entered into on their behalf.

C.

We next consider whether the release defense interposed by the federal court defendants applies to preclude the federal securities case from proceeding forward. In the federal lawsuit, the plaintiffs have alleged claims that were resolved by the final judgment entered into by the state court.[10] Even though the state court did not have subject

10. The language contained in the release negotiated by the parties was very broad in scope, *see supra* note 1, and manifests an intent to settle

matter jurisdiction to consider a suit alleging violations of the federal securities laws, the judgment entered by the court must be given due accord by a subsequent federal court entertaining a lawsuit based upon facts and transactions conclusively determined in the state court proceeding.

The district court made a factual finding that Grimes presented arguments during the state court proceeding concerning disclosure requirements under federal law. *Grimes*, No. 92-2722, 1993 WL 56032, at *2.[11] The facts that underlie the federal non-disclosure claims were actually litigated during the state court proceeding and were conclusively resolved against the objectors, here the federal plaintiffs. *Grimes*, No. 92-2722, 1993 WL 56032, at *5 ("[T]he plaintiffs and the objectors, including plaintiff

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all disputes that did or might arise out of the merger transaction. Consistent with the reading of the district court, *see Grimes*, No. 92-2722, 1993 WL 56032, at *3, we interpret the settlement agreement to release all potential causes of action, even those like the present claims that can only be brought in federal court. *See, e.g., Erie Communications, Inc. v. City of Erie, Pa.*, 853 F.2d 1084, 1097 (3d Cir. 1988) (broad language of a release "was obviously meant to put an end to all disputes . . . arising out of" a franchise agreement transaction).

> "Under Delaware law, even a provision that releases 'any matter related to any of the acts or transactions described in the complaints in the said actions' will not be struck down as too general." *Nottingham Partners*, 925 F.2d at 33 n.3 (quoting *Rutman v. Kaminsky*, 226 A.2d 122, 126 (Del. 1967)). Thus, as the *Nottingham Partners* court found, "breadth is not a problem." 925 F.2d at 33 n.3.

11. The district court stated: "Grimes argued that defendants had breached their duty of care in approving the offer and merger, and breached their duty of candor under Delaware law *and federal securities laws*." *Id.* (emphasis added). Although Grimes and Holbrook have not specifically argued that this factual finding is clearly erroneous, we have reviewed it and find it amply supported by the record. *See In re Vitalink*, [1991-92 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,585, at 92,743 (Del. Ch. Nov. 8, 1991) ("The objectors argue that the Board failed to satisfy their duty of candor under Delaware law and their duty not to make material misrepresentations in the offering documents under federal law.").

Grimes, actually litigated the disclosures accompanying defendants' offer and merger into N[etwork]"). *See also In re Vitalink*, [1991-92] Fed. Sec. L. Rep. (CCH) ¶ 96,585, at 92,743-45 (Del. Ch. Nov. 8, 1991) (the Delaware Court of Chancery fully considered and rejected all of the objectors' non-disclosure arguments). As a result, the plaintiffs cannot relitigate in federal court the issues of non-disclosure and fairness of the settlement that were conclusively determined in the Delaware proceeding.

We are compelled to conclude that the present lawsuit is barred by the terms of the federal full faith and credit statute. *See* 28 U.S.C. § 1738. "The preclusive effect of a state court judgment in a subsequent federal lawsuit generally is determined by the full faith and credit statute, which provides that state judicial proceedings 'shall have the same full faith and credit in every court within the United States ... as they have by law or usage in the courts of such State ... from which they are taken.'" *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 380, 105 S. Ct. 1327, 1331-32 (1985) (quoting 28 U.S.C. § 1738). In *Marrese*, the Court considered whether the federal full faith and credit statute operates to preclude a federal court from considering exclusive federal antitrust claims that arose from the same transaction that was the subject of a prior state law action in which the state court entered a final judgment dismissing all claims.

The Court held that the federal full faith and credit statute can operate to bar the relitigation of issues decided by the state court, even though the state court would not have subject matter jurisdiction to consider the federal claims in the first instance, if state law would give the state court judgment preclusive effect. *Id.* at 380-81, 105 S. Ct. at 1332. Viewed properly as an interpretation of the full faith and credit statute, the *Marrese* decision is consistent with earlier Supreme Court cases requiring a subsequent federal court to look to state law to determine whether issue preclusion is a necessary consequence of the prior state court litigation. *See Migra v. Warren City Sch. Dist. Bd. of Educ.*, 465 U.S. 75, 81, 104 S. Ct. 892, 896 (1984); *Kremer v. Chemical Const. Corp.*, 456 U.S. 461, 480-82, 102 S. Ct. 1883, 1897-98 (1982) ("The full faith and credit

statute "does not allow federal courts to employ their own rules of res judicata in determining the effect of state judgments. Rather, it goes beyond the common law and commands a federal court to accept the rules chosen by the State from which the judgment is taken."); *cf. Allen v. McCurry*, 449 U.S. 90, 95-96, 101 S. Ct. 411, 415-16 (1980) (federal courts are required to give collateral estoppel effect to prior state court judgments when state courts would do so). Thus, the Supreme Court instructs a federal court to inquire into the scope of state preclusion law when applying the full faith and credit statute to a prior state court judgment.

For present purposes, we find it unnecessary to determine whether operation of the full faith and credit statute could preclude a subsequent federal court from entertaining exclusive federal securities claims on the basis of res judicata. As the *Marrese* court held, where a state court would give a prior state judgment such broad res judicata effect, then a federal court is required to follow suit. 470 U.S. at 379-81, 105 S. Ct. at 1331-32.[12] We need not address this question because the district court expressly ruled that the federal claims had been released as a part of the state court judgment, *Grimes*, No. 92 2722, 1993 WL 56032, at *3, and that these claims were precluded by the collateral estoppel effect of this judgment, *id.* at *4-5.

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12. The Supreme Court recognized that "a state court will not have occasion to address the specific question whether a state judgment has issue or claim preclusive effect in a later action that can be brought only in federal court." *Id.* at 381-82, 105 S. Ct. at 1332. This is necessarily so because a state court would not possess subject matter jurisdiction to entertain such a case in the first instance. We note, however, that a state court might need to address this issue as a collateral matter to determine the merits of an underlying legal claim such as attorney malpractice, or to determine the rights of certain parties in a state receivership proceeding. Such an inquiry by a state court of competent jurisdiction would be rare indeed. To the limited extent the Delaware courts have addressed this question, they recognize that the parties to a fair and procedurally sufficient global settlement "are bound by the release or the doctrine of issue preclusion." *In re MCA, Inc.*, 598 A.2d 687, 691 (Del. Ch. 1991).

As we previously indicated, we agree with the district court that the language of this broad release manifests an intent by the parties to settle all claims arising from the merger transaction. *See supra* note 10. In addition, we have determined that all class members, including Grimes and Holbrook, are constitutionally bound by the prior judgment. Therefore, the full faith and credit statute operates to bar a federal court from considering any claims arising from the merger transaction if a Delaware state court would find that the judgment precludes the relitigation of any issues conclusively determined in the state court proceeding.

As the district court found when it analyzed state law, *Grimes*, No. 92-2722, 1993 WL 56032, at *4, Delaware follows the usual rule that a judgment in one case constitutes a final determination concerning questions of fact litigated by the parties. *See E.B.R. Corp. v. PSL Air Lease Corp.*, 313 A.2d 893, 894 (Del. 1973); *Winkler v. Balentine*, 254 A.2d 849, 851 (Del. 1969); *accord Nottingham Partners*, 925 F.2d at 32. Since a state court would conclude that the plaintiffs are collaterally estopped from relitigating the factual issues of nondisclosure, adequacy of representation, and fairness of the settlement that they raise in this lawsuit, the district court correctly ruled that the federal defendants were entitled to summary judgment. In short, the full faith and credit statute requires the federal court to give collateral estoppel effect to the state court judgment. Since this judgment places the court's stamp of approval on a broad release of all claims arising from the merger transaction, including any exclusive federal claims, the subsequent federal court is precluded from entertaining a case involving claims arising from the same nucleus of operative facts.

D.

While this rule of law may seem anomalous at first glance, it is widely recognized that courts without jurisdiction to hear certain claims have the power to release those claims as part of a judgment. *See, e.g., Class Plaintiffs v. City of Seattle*, 955 F.2d 1268, 1287-88 (9th Cir.), *cert. denied*, __ U.S. __, 113 S. Ct. 408 (1992) (a federal court may release not only claims alleged in the

complaint, but also state claims arising from the same nucleus of operative facts over which the court would not have jurisdictional competency); *TBK Partners, Ltd. v. Western Union Corp.*, 675 F.2d 456, 460 (2d Cir. 1982) (same); *In re Corrugated Container Antitrust Litig.*, 643 F.2d 195, 221-22 (5th Cir. 1981), *cert. denied*, 456 U.S. 998, 102 S. Ct. 2283 (1982) (same). This rule of law serves the important policy interest of judicial economy by permitting parties to enter into comprehensive settlements that "prevent relitigation of settled questions at the core of a class action." *TBK Partners*, 675 F.2d at 460.

Nor is this rule of law limited to federal courts entering judgments that release state claims that they would not have jurisdictional competency to entertain in the first instance. We hold that as a matter of federal law a state court has the power to enter a settlement negotiated by the parties as a judgment which releases exclusive federal claims that the state court could not itself entertain. With this holding, we follow several other federal courts that have recognized the broad power of state courts to approve and enforce settlements which reflect the parties' intent to release all claims arising from a transaction regardless of whether the class-action court has jurisdictional competency to hear those claims. *See Nottingham Partners*, 925 F.2d at 34; *Abramson v. Pennwood Inv. Corp.*, 392 F.2d 759, 762 (2d Cir. 1962). *See also Sandler Assocs., L.P. v. BellSouth Corp.*, 818 F. Supp. 695, 704-05 (D. Del. 1993), *appeal filed*, No. 93-7343 (3d Cir. May 12, 1993); *Lowenschuss v. Resorts Int'l*, No. 89-1071, 1989 U.S. Dist. LEXIS 7407, at *20 n.15 (E.D. Pa. June 29, 1989).

Despite the well established authority for this legal proposition, the federal plaintiffs urge this court to hold that the state court did not have power to enter such a broad release based on the rationale put forth by Judge Friendly in *National Super Spuds, Inc. v. New York Mercantile Exch.*, 660 F.2d 9, 18-19 (2d Cir. 1981). In *National Super Spuds*, the U.S. Court of Appeals for the Second Circuit ruled that a federal court was not precluded from entertaining a federal claim despite an earlier broad release entered into by the parties to a state court proceeding. *Id.* at 17-18. However, *National Super Spuds* is

distinguishable from the case *sub judice* because the federal plaintiff brought claims based on unliquidated futures contracts, while the state court class was organized only to litigate claims based on futures contracts liquidated during the relevant time period. *Id.*

Thus, our holding today is not inconsistent with the holding of the *National Super Spuds* court that a state court class representative cannot release federal claims arising from a different factual predicate than that before the state court. Judge Friendly expressly limited the opinion to the facts before the court by recognizing that "a settlement could properly be framed so as to prevent class members from subsequently asserting claims relying on a legal theory different from that relied upon in the class action complaint but depending upon the very same set of facts." *Id.* at 18 n.7. While *National Super Spuds* was "not such a case," *id.*, the present one is.

IV.

We conclude that the district court properly entered summary judgment in favor of the defendants because all of the elements of a dispositive release defense were present. As a member of the plaintiff class who owned Vitalink stock and tendered his shares, plaintiff Holbrook had sufficient contacts with the Delaware forum such that the Court of Chancery could exercise specific jurisdiction to adjudicate his stock ownership rights. Furthermore, the state court judgment releasing all claims arising from the merger transaction was entitled to full faith and credit by the district court even though the state court did not have jurisdictional competency to entertain the present exclusive federal claims. We will affirm the judgment of the district court. Each party will bear its own costs.

HUTCHINSON, *Circuit Judge*, dissenting.

I respectfully dissent from the Court's mandate insofar as it affirms the district court's dismissal of Holbrook's federal actions. I concur with the Court's holding that Grimes and other members of the non-opt-out plaintiff class, over whom the Delaware Court of Chancery had personal jurisdiction, are bound by the class representatives' general release of all of the class members' claims that arise out of the merger of Vitalink with Network, including claims under federal securities law, for material misrepresentations which the defendants may have made in connection with the merger and the stock subject to the tender offer. I think Holbrook is not bound because the courts of Delaware lacked personal jurisdiction over him. I reason as follows.

I.

A.

Holbrook is not a Delaware resident, he has not consented to jurisdiction and he was not given a chance to opt out. Nevertheless, in Part III.B. of its opinion, the Court holds that his tender of shares of stock he owned in a Delaware corporation meets *International Shoe*'s due process test of minimum contacts. It concludes these tenuous contacts with Delaware permit a court of that state, sitting in equity, to exercise *in personam* jurisdiction over Holbrook as a member of a Rule 23(b)(1) or (b)(2) non-opt-out class. Because of its conclusion that the state court had personal jurisdiction over Holbrook, the Court goes on to hold that the class representatives' settlement of a state suit to enjoin the merger of Vitalink and Network on the theory that Vitalink's officers and directors deceitfully or fraudulently breached their common law fiduciary duties to the corporation or its shareholders binds Holbrook.

Finally, the Court holds that a non-resident who never consented to class representation in a state court is not only precluded from further equitable relief by a release of claims incorporated into the settlement decree but also from all legal actions for money damages, including actions

Congress has entrusted to the exclusive jurisdiction of federal courts.

In doing so, the Court recognizes that due process prohibits the courts of any particular state from exercising personal jurisdiction over a non-resident absent minimum contacts. *See International Shoe v. Washington*, 326 U.S. 310, 316 (1945). I think it errs, however, in concluding that Holbrook's stock ownership, when coupled with his tender of stock in accord with the tender offer that he claims violated federal law, gives Delaware the "minimum contacts" which are necessary before a state court can exercise personal jurisdiction over non-resident, non-consenting members of a class that otherwise purports to include all the stockholders of one of that state's domestic corporations.

Under the Supreme Court's jurisprudence placing due process limitations on a court's exercise of jurisdiction, it is clear that the exercise of such jurisdiction must comport with "traditional notions of fair play and substantial justice." *See International Shoe*, 326 U.S. at 320. Specifically, the Supreme Court has stated:

> The Due Process Clause protects an individual's liberty interest in not being subject to the binding judgments of a forum with which he has established no meaningful "contacts, ties, or relations." [] By requiring that individuals have "fair warning that a particular activity may subject [them] to the jurisdiction of a foreign sovereign," [] the Due Process Clause "gives a degree of predictability to the legal system that allows potential defendants to structure their primary conduct with some minimum assurance as to where that conduct will and will not render them liable to suit. . . ."

Burger King Corp. v. Rudzewicz, 471 U.S. 462, 471-72 (1985) (citations and footnote omitted). I believe that the Delaware court's exercise of jurisdiction over Holbrook does not comport with this standard.

In *Shaffer v. Heitner*, 433 U.S. 186 (1977), the Supreme Court extended *International Shoe* to all exercises of state court jurisdiction, including exercises of *quasi in rem* jurisdiction. *Shaffer* involved a shareholder's derivative

action, filed in Delaware state court against officers and directors of a Delaware corporation, including some officers and directors who were non-residents of Delaware. *Shaffer*, 433 U.S. at 189-96. The Delaware court exercised *quasi in rem* jurisdiction over these nonresident defendants by sequestering their stock in a Delaware corporation. *Id.* at 196. The United States Supreme Court held that the non-resident officers' and directors' ownership of stock in a Delaware corporation did not give Delaware the minimum contacts due process required. *Id.* at 213-14. Accordingly, the Supreme Court decided Delaware's Chancery Court could not subject non-resident officers and directors who owned shares in a Delaware corporation to a sequestration procedure. *Id.* at 216-17. Justice Stevens specifically noted that "[o]ne who purchases shares of stock on the open market can hardly be expected to know that he has thereby become subject to suit in a forum remote from his residence and unrelated to the transaction." *Id.* at 218 (Stevens, J., concurring).

Despite the Supreme Court's holding in *Shaffer*, the Delaware Chancery Court, in *Hynson v. Drummond Coal Co.*, 601 A.2d 570, 579 (Del. Ch. 1991), concluded that ownership of stock in a Delaware corporation is a sufficient basis for a Delaware court to exercise jurisdiction over the corporation's stockholders. I believe that *Hynson* is inconsistent with *Shaffer* and that the Delaware Chancery Court's position that it could exercise, in this case, personal jurisdiction over absent class members who have not been given an opportunity to opt out solely because they own stock in a Delaware corporation runs afoul of the Due Process Clause of the Fourteenth Amendment to the Constitution. Because *Hynson* was not appealed, we do not have the benefit of the Delaware Supreme Court's view on this issue.

Shaffer is not the only case which has held, or implied, that ownership of stock in a domestic corporation is not enough of a contact to give the courts of the state of incorporation personal jurisdiction over the corporation's stockholders. Even when that ownership is coupled with other local contacts connected with the acquisition or disposition of a domestic corporation's stock, courts have

held that they have no personal jurisdiction over nonresident stockholders. *See Edwards v. Geosource, Inc.*, 473 So. 2d 36, 37 (Fla. Dist. Ct. App. 1985) (mere ownership of stock in Florida corporation, coupled with execution of promissory note to purchase the stock, insufficient contacts to confer personal jurisdiction); *cf. Cannon Mfg. Co. v. Cudahy Packing Co.*, 267 U.S. 333, 336-38 (1925) (activities of subsidiary corporation did not subject parent holding stock in subsidiary to local court's jurisdiction absent parent's control of subsidiary or other facts permitting corporate veil to be pierced). *But see Gaudio v. Gaudio*, 580 A.2d 1212, 1220 (Conn. App. 1990) (dictum) (noting plaintiff's argument that mere ownership in stock was an insufficient contact "might be persuasive if the transaction at issue involved the relatively routine and anonymous purchase of publicly traded stock through a broker or agent" but that an express agreement to purchase stock could supply the necessary contact).

Shaffer shows this Court's decision not to rely solely on Holbrook's ownership of stock is wise. While I agree with the Court that in this case we are concerned with specific jurisdiction, I am unable to see how Holbrook's response to the tender offer he claims was misleading under the federal disclosure laws adds any material contact with Delaware or, alternately, supplies sufficient evidence of consent to personal jurisdiction to satisfy due process. Whether stock ownership coupled with a tender under the offer a plaintiff claims is misleading as a matter of federal law provides the minimum contacts due process requires seems to be a question of first impression on which I have uncovered no specific authority. The Court cites *Hanson v. Denckla*, 357 U.S. 235, 253 (1958) and *Carteret Savings Bank, FA v. Shushan*, 954 F.2d 141, 146-48 (3d Cir.), *cert. denied*, 113 S. Ct. 61 (1992), in support of its proposition that the tender was a sufficient contact. I do not think these cases answer the question. Neither have anything to do with tender offers. *See Hanson*, 357 U.S. at 251-52 (Florida had no personal jurisdiction over Delaware trust when trustee later became domiciled in Florida because the trust company did not transact business there and none of the trust assets were held there); *Carteret*, 954 F.2d at 149-50 (when Louisiana attorney not only telephoned and

corresponded with client's management in New Jersey but also traveled to New Jersey to meet with management concerning transaction in question, lawyer and his law firm had minimum contacts courts in New Jersey needed to exercise personal jurisdiction over defendant in claim for breach of duty in preparing contract). I do not think these cases support the Court's position. Though I am equally unable to cite authority directly on point, I believe the effect of depriving Holbrook of his exclusively federal securities claims which the Court's holding has done does not square with the federalism component I believe to be intertwined in the due process requirements concerning personal jurisdiction.[1]

B.

The question thus becomes whether a lack of minimum contacts deprives a court-approved consent decree settling a Rule 23(b)(1) or (2) class action of any binding effect on non-resident, non-consenting members of a non-opt-out class. The Supreme Court has stated generally that *International Shoe*'s test of "traditional notions of fair play and substantial justice" applies to all exercises of state court jurisdiction, and it has never explicitly held a court can exercise personal jurisdiction over absent unconsenting members of a plaintiff class if minimum contacts are lacking.

This general principle, however, is set out in cases involving jurisdiction over individual, as opposed to class, defendants. *See, e.g., Burger King Corp.*, 471 U.S. at 471-72; *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 295 (1980). Thus, some courts have relied on *Hansberry v. Lee*, 311 U.S. 32 (1940), to indicate that a court may bind unnamed members of a plaintiff class without personal jurisdiction over all of them. *See Miner v. Gillette Co.*, 428 N.E.2d 478, 481 (Ill. 1981), *cert. dismissed*, 459 U.S. 86 (1982); *Katz v. NVF Co.*, 462 N.Y.S.2d 975, 977 (1983), *rev'd on other grounds*, 473 N.Y.S.2d 786 (1984). These courts base this conclusion on dictum in *Hansberry* which says that a class action may be appropriate for

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1. *See infra* pp. 38-39 for a discussion of the impact of federalism.

"causes in which the number of those interested in the litigation is so great as to make difficult or impossible the joinder of all because some are not within the jurisdiction . . . ." *Hansberry*, 311 U.S. at 41. I think they overlook the teaching of *International Shoe*, decided after *Hansberry*.

Indeed, in *Hansberry*, the Court repeated the principle that "one is not bound by a judgment in personam in a litigation in which he is not designated as a party or to which he has not been made a party by service of process." *Hansberry*, 311 U.S. at 40 (citing *Pennoyer v. Neff*, 95 U.S. 714 (1878)).[2] The Supreme Court went on to state that the considerations which induce a court to certify a class differ from those it must consider in deciding whether absent members of the class will be bound by the decree. *Id.* at 42. Perhaps foreshadowing *International Shoe*, it then said: "[T]here has been a failure of due process only in those cases where it cannot be said that the procedure adopted, fairly insures the protection of the interests of absent parties who are bound by it." *Id.*

No issue of personal jurisdiction was before the Court in *Hansberry*, and it seems to me a conclusion that a court may bind unnamed class members ignores *Hansberry*'s distinction between the requirements for valid class actions and the limitations due process puts on their preclusive effect on absent, non-consenting class members. It is also in stark conflict with the Supreme Court's holding in *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 (1985), that due process requires non-resident, non-consenting class members be given notice, an opportunity to be heard, and a chance to opt out. 472 U.S. at 812. Therefore, it does not seem to me that *Hansberry*'s dictum stating a class suit "may bind members of the class or those represented who were not made parties to it" announces an exception to the general principle that a party is not bound by a court's order unless it has personal jurisdiction over him. *Hansberry*, 311 U.S. at 41.

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2. *Pennoyer*'s so-called iron fence theory of territorial jurisdiction was expressly superseded by *International Shoe*'s more flexible due process test. *See International Shoe*, 326 U.S. at 316.

Many cases which state or seem to imply that personal jurisdiction can be exercised over absent members of a plaintiff "class" without minimum contacts are "common fund" cases in which the court entertaining the action had jurisdiction over nonresident members. Jurisdiction there is present because the plaintiffs have a property interest in the fund or alternately because the court had *in rem* or *quasi in rem* jurisdiction over the fund. *See, e.g., Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950); *Supreme Tribe of Ben-Hur v. Cauble*, 255 U.S. 356 (1921), *overruled on other grounds, Toucey v. New York Life Ins. Co.*, 314 U.S. 118 (1941); *Hartford Life Ins. Co. v. Ibs*, 237 U.S. 662 (1915). *See also generally* Barbara A. Winters, *Jurisdiction Over Unnamed Plaintiffs in Multistate Class Actions*, 73 Calif. L. Rev. 181 (1985). The case now before us is not a typical limited fund or common interest case. It has its genesis in its state, as well as federal, version of what Holbrook alleges is the defendants' fraud or deceit in connection with a merger the state court plaintiffs unsuccessfully sought to enjoin. In any event, I believe the procedural rules governing class actions in all courts, state and federal, are subject to due process under either the Fifth Amendment or the Fourteenth Amendment, as it applies to the states.[3]

The *Shutts* case arose when a class of leaseholders brought suit over royalty payments in Kansas state court. Almost all of the plaintiffs and leases lacked any

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3. Similar problems of personal jurisdiction arose as interpleader evolved in the United States. There, in an effort to avoid the problem of personal jurisdiction that accompanies a federal system of dual state and national sovereignty, parties to claims against insurance companies, entities that commonly face conflicting claims to a single fund, sought from the one side to attach the obligation or from the other to pay it into court in order to create a res whose ownership could be litigated without a need for personal jurisdiction. In one of these cases, on appeal from this Court, the Supreme Court rejected such efforts to avoid the requirement of *in personam* jurisdiction. *New York Life Ins. Co. v. Dunlevy*, 241 U.S. 518, 522 (1916). Congress then attempted to solve the problem of personal jurisdiction by enacting the Federal Interpleader Act, now codified at 28 U.S.C.A. §§ 1335, 1397, 2361 (West 1993). It permits nationwide service of process in actions in interpleader. 28 U.S.C.A. § 2361.

relationship to Kansas. The class notification informed all members of the pendency of a class action that could affect them and provided them with the opportunity to opt out of the class. *Shutts*, 472 U.S. at 799-801. In upholding the class action, the Supreme Court specifically stated that an absent member of a plaintiff class who lacks minimum contacts with the state whose court is entertaining a class action cannot be bound by a judgment entered in it unless the plaintiff has received "at a minimum . . . an opportunity to remove himself from the class by executing and returning an 'opt out' or 'request for exclusion' form to the court." *Id.* at 812.

In *In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285 (2d Cir. 1992), *cert. dismissed sub nom. Hart Holding Co. v. Drexel Burnham Lambert Group*, 113 S. Ct. 1070 (1993), the court of appeals decided that members of a plaintiff class who had filed federal securities claims before Drexel filed for bankruptcy could be denied an opportunity to opt out of a settlement only because all of the class members had consented to the bankruptcy court's jurisdiction when they filed proofs of claim in the defendant's bankruptcy proceeding. *Id.* at 292.[4] In reaching this conclusion, the court of appeals noted:

> We are not unaware of the Supreme Court's statement in *Phillips Petroleum Co. v. Shutts*, 472 U.S. 797 [] (1985), that "due process requires at a minimum that an absent plaintiff be provided with an opportunity to remove himself from the class by executing and returning an 'opt out' or 'request for exclusion' form to the court." *Id.* at 812[]. *Shutts* mandates that a plaintiff be permitted to opt out of a proposed class when the court does not have personal jurisdiction over the plaintiff. *Id.* at 811-12[].

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4. *Cf. Doumani v. Casino Control Comm'n*, 614 F. Supp. 1465, 1471-73 (D.N.J. 1985) (New Jersey Casino Commission had *in personam* jurisdiction over nonresident shareholders of New Jersey casino corporation only because shareholders' substantial stock interest gave them ability to significantly affect casino operation in New Jersey. Jurisdictional objection arguably waived.).

In re Drexel Burnham Lambert, 960 F.2d at 292 (parallel citations omitted).

Shutts has been the subject of much discussion by both courts and commentators. In *In re A.H. Robins Co.*, 880 F.2d 709, 744 (4th Cir.), *cert. denied sub nom., Anderson v. Aetna Cas. & Sur. Co.*, 493 U.S. 959 (1989), another court of appeals, analyzing *Shutts*' effect on mandatory non-opt-out class certification (*i.e.*, Rule 23(b)(1) and (2) classes), noted that some commentators view *Shutts* as holding " 'that a state court can bind absent class plaintiffs to a judgment for money damages (only) if it provides the absent parties the minimal procedural protections of adequate representation, notice of the action, and an opportunity to opt out of the litigation.' " *Id.*[5] The court also noted a commentary which concludes " '[t]here is no neat and logical means of resolving the question whether mandatory actions survive *Shutts*.' " *In re A.H. Robins Co.*, 880 F.2d at 744 (quoting Arthur R. Miller & David Crump, *Jurisdiction and Choice of Law in Multistate Class Actions After Phillips Petroleum Co. v. Shutts*, 96 Yale L.J. 1, 52 (1986)).

In re A.H. Robins Co. was a Rule 23(b)(1) action. There, the court referred to commentary concerning the binding effect of Rule 23(b)(2) class actions on non-residents who were not given a chance to opt out. Quoting this commentary, the court of appeals said:

> The problem of the Rule 23(b)(2) class action is that binding absent class members without giving them notice and the right to opt out violates due process. The problem is clear under the apparently applicable standards of *Phillips Petroleum Co. v. Shutts*. Indeed, the only way in which the binding Rule 23(b)(2) class action might be seen not to be a violation of due process is if one follows *Matthews v. Eldridge* and weighs the harm to the interests of absentees with the

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5. Quoting Note, *Phillips Petroleum Company v. Shutts: Procedural Due Process and Absent Class Members: Minimum Contacts In Out—Is Individual Notice In?*, 13 Hastings Const. L.Q. 817, 821 (1986); Note, *Phillips Petroleum Company v. Shutts: Multistate Plaintiff Class Actions: A Definite Forum, But Is It Proper?*, 19 John Marshall L. Rev. 483, 485 (1986).

> cost of the alternative safeguard of notice and the right to opt out.

In re A.H. Robins Co., 880 F.2d at 744-45[6] (quoting Mark Weber, *Preclusion and Procedural Due Process in Rule 23(b)(2) Class Actions*, 21 U. Mich. J.L. Ref. 347, 394 (1988) (footnote omitted in original)).[7]

Shutts, on its facts, was a plaintiff class's action for money damages, and the Supreme Court expressly reserved the question whether its holding applied to cases in which a plaintiff class sought equitable relief. *Shutts*, 472 U.S. at 811 n.3. Accordingly, some commentators and courts have concluded that *Shutts* has no application to cases in which a plaintiff class seeks relief that is primarily equitable in nature. *See, e.g.*,*White v. National Football League*, 822 F. Supp. 1389, 1410-11 (D. Minn. 1993) (reading *Shutts* to require a chance to opt out only in actions that concern claims "wholly or predominantly for money judgments" and not claims in which injunctive relief is the predominate relief sought) (citing *Shutts*, 472 U.S. at 811-12 & n.3); *see also In re Jackson Lockdown/MCO Cases*, 107 F.R.D. 703, 713-14 (E.D. Mich. 1985).

If this conclusion is correct in its broad sense, a chance to opt out is not required when a class is properly certified as a Rule 23(b)(1) or (2) class. A brief excursion into the genesis of class actions and their present division among

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6. For an analogous solution proposing factors for a balancing test, *see* Miller & Crump, *supra*, at 55-56. They propose a four factor balancing test to determine the propriety of mandatory class certification after *Shutts*. The factors they would consider are: (1) efficiency, *i.e.*, the economies of scale that can be achieved in a class action; (2) equity concerns, *i.e.*, whether some plaintiffs will be unfairly harmed if other plaintiffs litigate first and whether defendants may be subjected to multiple liability, such as is present in the mass tort cases by virtue of punitive damages; (3) the concern about distant forum abuse; and (4) the interest in individualized control. *Id.*

7. The court of appeals in *In re A.H. Robins Co.*, after extensively discussing *Shutts*' impact on actions for money damages and recognizing that even "if [*Shutts* is] taken as requiring an opt-out provision in *any* class certification," did not reach or decide the issue of jurisdiction because the Trust Plan did include an implied chance to opt out. *In re A.H. Robins Co.*, 880 F.2d at 745 (emphasis added).

Rule 23(b)(1), (2) and (3) may help explain, but not necessarily justify, this conclusion.[8] Our class actions originated in the English bill of peace. They were originally cognizable only in equity, *see* Charles A. Wright et al., 7A *Federal Practice & Procedure Civil 2d* (hereinafter "*Federal Practice & Procedure*"), § 1751, at 7-10, because the procedural tools available in the law courts were not adequate to protect the rights of unknown parties. *See id.* § 1751, at 11. Because of its utility, the class suit in equity came to this country with the common law and was eventually incorporated into numerous state procedural codes. "The obvious advantage of the representative suit was that it was far cheaper and more convenient to maintain a single proceeding in equity than to adjudicate the controversy in piecemeal fashion by multiple actions at law." *Id.* § 1751, at 8.

As the modern class action evolved from this background, its efficiency in disposing of claims involving common issues affecting many persons resulted in an expansion of its use that took it beyond the confines of the old bill of peace. Ultimately, it was extended to actions at law. *See id.* § 1751, at 11. Since then, class actions have been divided into three parts. They were originally referred to as "spurious," "hybrid" and "true." Under the Federal Rules of Civil Procedure, these terms were abandoned in the 1966 amendments to our rules. *See generally* 7A *Federal Practice & Procedure* § 1752 at 16. The "spurious" class action covered separate claims with common

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8. The text of Delaware Chancery Rule 23 is the same as that of Federal Rule of Civil Procedure 23. Both jurisdictions recognize non-opt-out classes under (b)(1) and (b)(2). *Cf.* Fed. R. Civ. P. 23(b)(1), (b)(2); *In re Joint Eastern & Southern District Asbestos Litig.*, 982 F.2d 721, 739 (2d Cir. 1992) (mandatory non-opt-out class under Rule 23(b)(1)(B) in action seeking equitable distribution of res of trust established pursuant to confirmed Chapter 11 Plan), *opinion modified on reh'g*, 993 F.2d 7 (2d Cir. 1993). I note that Wright and Miller, in discussing antitrust and securities fraud actions including those for misrepresentation, generally refer only to Federal Rule 23(b)(3), not (b)(1) or (b)(2), as a vehicle for the class action suit. *See* Charles A. Wright et al., 7B *Federal Practice & Procedure Civil 2d* (hereinafter "*Federal Practice & Procedure*") § 1781 at 4-5, 33; *id.* § 1778 at 529-33 & n.14. Thus, it is not clear to me that this case involves a non-opt out class.

questions of law or fact. It loosely resembled today's Rule 21(b)(3) action. In a spurious class action, the class remedy was dependent solely on multiplicity or numerosity of parties. "True" class actions involved joint or common interests. They arose naturally out of the old bill of peace. "Hybrid" actions involved claims against limited pools of property or cash that bear some analogy to estates or trusts of all kinds.[9] There, equity's long experience with the administration of estates commonly requiring resolution of competing claims to a *res* among various kinds of creditors and classes of beneficiaries provided an additional underpinning for the remedy of class relief with its origin in equity.

Members of true classes were wholly bound by res judicata, but hybrid class members were bound only to the extent that their claims concerned the fund before the court. *See* Miller & Crump, *supra*, at 39-40 & n.276. The 1966 amendments to Federal Rule 23(b)(1) and 23(b)(2) brought most of the actions that would have been labelled true or hybrid under the Rule's original terminology within Rule 23(b)(1) or (2). *Id.* at 40 & n.277. As I have stated, others involving only common issues affecting many persons, generally fall under Rule 23(b)(3).

Both Federal Rule of Civil Procedure 23, and Delaware's Rule governing class actions provide in a class action maintained under subdivision (b)(3) that notice advising class members of their right to opt out of the class must be given. *See* Fed. R. Civ. P. 23(c)(2); Del. Chanc. R.P. 23(c)(2). By negative implication, however, this right to notice and a chance to opt out has been thought not to apply to class actions maintained under subdivisions (b)(1) and (b)(2). Thus, Rule 23(b)(1) & (2) class actions are often referred to as mandatory class actions.

Though *Shutts* was not a mandatory class action, *i.e.*, one certified under Rule 23(b)(1) or (b)(2) and thus left the due

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9. *Cf. Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306 (1950) (involving question of due process notice requirement in judicial settlement of trust fund, where trust company sought binding settlement over all beneficiaries of the trust on the sole basis of notice by publication).

process concerns implicated by mandatory classes unresolved, it did not limit its discussion of due process and its requirement of personal jurisdiction to Rule 23(b)(3) classes. Accordingly, Miller and Crump in their commentary have concluded that the right to opt out is a fundamental due process requirement which conflicts with the notion of a mandatory non-opt-out class that has developed, somewhat insensibly, under Rule 23(b)(1) & (2). In what may perhaps appear to be a bit of semantic overstatement, they say: "There can be no 'mandatory class' if the members have the constitutional right to opt out." Miller & Crump, *supra*, at 39 (single quotes added). Of course, it is clear, even under *Shutts*, that a court can deny a class member a right to opt out if either the member or the object of the action has sufficient contact with the forum, just as any absent person can be joined involuntarily as a defendant and later discover that his interest in a particular res has been affected by orders issued in actions *in rem* or *quasi in rem*. With these exceptions, Miller and Crump suggest that *Shutts* "prohibit[s] mandatory class certification completely [because that] result seems supported by the unconditional statement of the right to opt out in *Shutts*." *Id.* at 54. Where a member of a plaintiff class lacks the minimum contacts that are necessary to give the courts of a particular state personal jurisdiction over him, I too believe *Shutts* implies his involuntary inclusion in a mandatory class certified under Rule 23(b)(1) or (b)(2) should be prohibited unless he is given notice and a chance to opt out.

Recently, in *Carlough v. Amchem Products, Inc.*, 10 F.3d 189, ___ (3d Cir. 1993), we stated "It would offend the Fifth Amendment's guarantee of due process for a federal court to enjoin an absentee class member whose minimum contacts with the forum have not been established or, in lieu of minimum contacts, who has not consented to the court's jurisdiction, explicitly or inferentially."

Moreover, *In re Real Estate Title & Settlement Services Antitrust Litigation*, 869 F.2d 760, 769 (3d Cir.), *cert. denied sub nom. Chicago Title Insurance Co. v. Tucson Unified School District*, 493 U.S. 821 (1989), also contains dicta supporting my conclusion that any class member lacking

minimum contacts with the forum entertaining the class action must be given a chance to opt out. It involved a federal injunction of a state action for violations of state antitrust law on the basis of a prior class action settlement in the district court. We referred to the fact that the classes were certified pursuant to Federal Rule 23(b)(1) and (b)(2) making them "types of class actions that do not provide the right to opt out." *Id.* at 763. We went on to hold that a federal district court could not enjoin a state court action for damages. We stated that a member of a plaintiff class who lacks minimum contacts must have a chance to opt out before a court can exercise personal jurisdiction over him:

> [I]f the member has not been given the opportunity to opt out *in a class action involving both important injunctive relief and damage claims*, the member must either have minimum contacts with the forum or consent to jurisdiction in order to be enjoined by the district court that entertained the class action.

Id. at 769 (emphasis added and footnote omitted).

Despite these dictum, the question whether due process requires either minimum contacts or an opportunity to opt out in a case like this has heretofore been an open question in this Court. *See In re Real Estate Title & Settlement Servs. Antitrust Litig.*, 869 F.2d at 768-69 ("We need not reach the issue, left open by *Shutts* . . . whether an absent plaintiff can be bound to the judgment in a hybrid (damage and injunctive) class action if it was not afforded the opportunity to opt out.") (emphasis added & citation omitted).

In this case, I think the issue is squarely presented. Here, the plaintiff class settled a state case in which it had sought equitable relief in the form of an order enjoining the proposed merger. Alternately, it sought compensatory and rescissionary damages if injunctive relief proved inappropriate or untimely.

I do not think the distinction between cases seeking equitable relief as opposed to money damages has any logical relation either to Fourteenth Amendment or Fifth Amendment concepts of due process's requirement of

personal jurisdiction. Rather, it seems to me only a vestigial reminder of the different ways in which the law relating to joinder of parties evolved in courts of equity as opposed to courts of law. *See infra* at 29-30.

Accordingly, I am unable to conclude that the arcane distinction between equitable jurisdiction based on multiplicity of parties (Rule 23(b)(3)) and equitable jurisdiction in cases involving multiple parties where multiplicity was coupled with an independent basis of equitable jurisdiction, *e.g.*, injunction, interpleader, etc. (Rule 23(b)(1) & (2)) affects the restrictions due process places on a court's exercise of jurisdiction *in personam*.

Thus, if a decision on money damages is to bind a non-resident, non-consenting member of a class, I think the Constitution requires an opportunity to opt out in the absence of minimum contacts whether the class action has as its basis only a common question involving many parties or an independent basis for equitable intervention.

Some courts and scholars contend, however, that giving non-consenting, non-resident class members who lack minimum contacts with the forum in which the class action is brought a right to opt out is likely to deprive class actions of their efficiency. The magnitude of that concern has been seriously questioned, however. *See* Miller & Crump, *supra*, at 37. In many multistate class actions, contacts will be adequate to establish jurisdiction over the person of all class members. They will almost always be so when the action concerns a joint interest in property or a common fund, or where the class members have engaged in activities in the forum. *See id.* Moreover, the efficiency of class actions should be weighed against the equitable and due process concerns implicated by the potential *res judicata* effect on non-resident and absent plaintiffs. *See supra* n.5. Professors Miller & Crump illustrate this problem as follows: "The rights of nonresident class members can be appreciated by considering . . . a class action . . . that is settled for much less than some class members think is reasonable." Miller & Crump, *supra*, at 16-17. In the case now before us, it is not too hard to understand how a non-consenting class member could think a settlement that puts no money in his pocket but

takes away his right to seek damages under federal laws entrusting his non-disclosure claims exclusively to federal courts is unfair.

II.

Thus, here the state court's attempt to release federal claims that Congress has placed in the exclusive jurisdiction of federal courts under the interstate commerce power Article I, Section 8, Clause 3 of the Constitution grants Congress, compounds the difficulties that arise if the Delaware decree binds Holbrook. It has been noted that the requirement of minimum contacts has as one of its elements a respect for the individual sovereignty of the various states and their dual sovereignty with the national government. That mutual respect is said to be inherent in our federalism. *See World-Wide Volkswagen*, 444 U.S. 286, 293-94 (1980); *see also* Miller & Crump, *supra*, at 32. Thus, in *World-Wide Volkswagen*, 444 U.S. at 291-94, the Supreme Court, concerned with upholding shared state interests, reaffirmed its commitment to the minimum contacts and fair play and substantial justice test of *International Shoe*. The restriction the Fourteenth Amendment imposes on state courts' exercise of personal jurisdiction serves not only the interest of the absent plaintiff but also acts in the interest of federalism. It ensures that states do not reach out beyond the limits of their power. *World-Wide Volkswagen*, 444 U.S. at 292-93; *but see Shutts*, 472 U.S. at 807 (endorsing approach of *Insurance Corp. of Ireland v. Compagnie des Bauxites de Guinee*, 456 U.S. 694, 702-03 & n.10 (1982), and stating "the requirement that a court have personal jurisdiction comes from the Due Process Clause's protection of the defendant's personal liberty interest and . . . the requirement 'represents a restriction on judicial power not as a matter of sovereignty, but as a matter of individual liberty.' ") (footnote omitted in original)); *cf.* Miller & Crump, *supra*, at 33 (indicating that approach of *Shutts* adopting limited role for federalism leaves open the question whether there are valid interests that will be left unprotected by the abandonment of the *World-Wide Volkswagen* approach). I do not think those concerns are present here and, in any

event, it would be my view that the liberty interest the due process clause protects is complemented by the common federal interest that is the concern of the commerce clause.

If the residual sovereignty of the individual states is part of the rationale behind the restrictions minimum contacts place on the state courts' exercise of personal jurisdiction over each other's citizens or residents, then it also seems to me that respect for the sovereignty of the federal government in areas in which the Constitution grants it power should also affect the power of a state to preclude the exclusively federal actions of persons who lack minimum contacts with that state or the cause it is hearing.[10]

Use of a state's mandatory class action to bar later actions by non-consenting, non-residents under the Securities Exchange Act of 1934 and the Williams Act thus seems to me to infringe on the mutual respect of the states and the federal government for each others' sovereignty that our federalism requires. *See Radzanower v. Touche Ross & Co.*, 426 U.S. 148, 157-59 & n.15 (1976); *see also* 15 U.S.C.A. § 78aa (West Supp. 1993). Balkanization of the national system regulating interstate commerce in corporate securities is foreseeable if each state can subject any non-resident stockholder of one of its domestic corporations to decrees which settle disputes about state corporate law by taking from non-consenting, non-resident shareholders remedies they may have under federal securities law against those who control the corporation.[11]

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10. Conventional notions of express or implied preemption were never presented here either in the district court or this Court. Therefore, I do not believe it would be appropriate to consider directly any actual or potential conflict between Delaware Rule 23(b)(2) and the Securities Exchange Act or the Williams Act.

11. The parties have cited only two courts of appeals' cases that have addressed a state court's power to relinquish federal rights through approval of a class action settlement. *See Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29, 33-34 (1st Cir. 1991); *Abramson v. Pennwood Investment Corp.*, 392 F.2d 759, 762 (2d Cir. 1968). *Abramson* was a federal stockholders derivative action that was barred because the corporation had released all related claims in a state court settlement. 392 F.2d at 760. Because *Abramson* was a derivative action, as opposed

III.

For all these reasons, I think that state courts have no power to bind non-resident shareholders, who do not consent to state jurisdiction, to state court settlements of disputes over local corporate law which include waivers of their federal claims. I would conclude that Holbrook's ownership of stock in a Delaware corporation and his tender pursuant to the tender offer that he claims failed to meet federal disclosure standards did not, consistent with due process, give the Delaware Court of Chancery *in personam* jurisdiction over him as a non-resident, non-consenting member of a non-opt-out class certified under Delaware Chancery Rule 23(b)(1) and (b)(2). That being the case, I do not think he is bound by the class representative's release of his federal securities law claims. I would therefore reverse the district court's order granting Vitalink's motion for summary judgment based on claim or issue preclusion arising out of the release of the parties the state court included in the consent decree insofar as that

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to a representative suit, the claims released belonged to the corporation and there should be little doubt about a corporation's ability to release its own claims. *See National Super Spuds, Inc. v. New York Mercantile Exch.*, 660 F.2d 9, 18-19 (2d Cir. 1980). This case is a representative action, not a derivative action. As such, it is distinguishable.

TBK Partners, Inc. v. Western Union Corp., 675 F.2d 456 (2d Cir. 1982), the other case cited by the parties, is also distinguishable. It concerned a settlement of a federal action that released defendants from all claims the plaintiff class might assert in a state appraisal proceeding. The objectors in *TBK Partners* never challenged the district court's certification of the class as a non-opt-out class. Thus, the court expressly reserved that question, stating "[w]e therefore do not consider the case of a release of claims of members of a class that had been improperly certified as a non-opt-out class." *Id.* at 460 n.4; *see also In re Real Estate Title & Settlement Servs. Litig.*, 869 F.2d 760, 770 (3d Cir.), *cert. denied*, 493 U.S. 821 (1989) (assuming that federal court in properly certified Rule 23(b)(1) and (2) class action could validly approve release of state claims). *Cf. Nottingham Partners*, 925 F.2d at 31, 34 (Delaware court had approved settlement of a class action including release of federal claims, but Nottingham had already unsuccessfully litigated its inclusion in a non-opt-out class in the Delaware proceedings).

order concerns Holbrook.[12] I would hold instead that Holbrook was not subject to the *in personam* jurisdiction of Delaware's Court of Chancery and that its attempt to bind him without his consent was a denial of due process. I would then enter an order remanding this case to the district court for further proceedings on Holbrook's claims under the federal law that regulates the sale and transfer of corporate securities.

A True Copy:
Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

12. Though our opinions in the case concern the rights of an absent plaintiff, we should not ignore the problems a defendant or defendants could face if a judgment or decree favorable to the plaintiffs binds the defendants but also permits non-consenting, non-resident plaintiffs to seek additional relief. One way to reduce that problem is to refuse to give non-consenting members of a plaintiff class the benefit of issue preclusion.

APPENDIX B
Opinion of the District Court
IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION
No: 92-2722

C.L. GRIMES and G.W. HOLBROOK, on their own behalf and on behalf of all persons similarly situated,
Plaintiffs,

v.

VITALINK COMMUNICATIONS CORP., A Corporation, NETWORK SYSTEMS CORPORATION, a corporation; LESLIE DENEND, J. DANIEL McCRANIE, CHARLES J. ABBE, HARRY T. REIN, and LYLE ALTMAN,
Defendants.

FILED MAR 1 1993

MEMORANDUM

Plaintiffs, former stockholders of Vitalink, have filed suit to challenge disclosures made in connection with defendant Vitalink's tender offer and merger into NSC. Plaintiffs allege that defendants violated federal securities laws. Jurisdiction arises under § 27 of the Securities Exchange Act, 15 U.S.C. § 78aa. Both parties have filed motions for summary judgment.[1] Presently before the court are two issues: first, whether a Delaware court judgment bars this action

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[1] Defendants' motion to dismiss under Fed.R.Civ.P. Rule 12(b)(6), upon plaintiffs' request, will be converted into a motion for summary judgment as provided under Rule 12(b). Defendants' motion introduced items outside of the pleadings, such as the affidavit of Steven W. Hardy.

on the grounds of collateral estoppel and release, and, secondly, whether the Delaware court proceedings violated due process. For the reasons that follow, I shall find that collateral estoppel and release do bar this suit from proceeding further in this forum. Plaintiffs having received all the process that was their due in Delaware, and shall thus grant defendants' motion for summary judgment and deny plaintiffs' motion for partial summary judgment.

BACKGROUND

Before the merger, defendants Vitalink and NSC were separate, publicly held, Delaware corporations. They both produced data communication products. After the merger, Vitalink became a whollyowned subsidiary of NSC. Plaintiffs, Grimes, a Pennsylvania citizen, and Holbrook, a Connecticut citizen, are former Vitalink stockholders and members of a class certified in a Delaware Chancery Court action.

On May 6, 1991, defendants NSC and Vitalink announced a merger agreement in which NSC, through a wholly owned subsidiary, agreed to acquire all the common stock shares of Vitalink. Vitalink sent a letter to the its stockholders, recommending that they accept the NSC offer and tender their stock at $10.50 per share. Plaintiff Holbrook tendered his stock in response to the offer. Plaintiff Grimes considered the tender price to be too low and did not tender his stock in response to the offer. The merger was completed on July 1, 1991.

Following the announcement of the merger agreement, Vitalink stockholders filed seven suits in Delaware and California. The plaintiffs in those actions alleged, *inter alia*, that the Vitalink defendants had breached their fiduciary duties owed to their stockholders. After taking discovery, the parties agreed to settle their claims. They negotiated a settlement in which the defendants agreed to (i) extend the offer, (ii) limit an amount payable to NSC

if the merger agreement was terminated, (iii) put a cap on NSC's right to reimbursement of fees and expenses, and (iv) promptly disclose the settlement. *In re Vitalink Communications Corp. Shareholders Litig.* Cons. C.A. No. 12085 (Del.Ch. Nov. 8, 1991). These provisions provided a potential bidder for Vitalink with additional time to make a bid and encouraged such a bid by making it less expensive. *See In re Vitalink,* at 33-34, 36-37.

On July 18, 1991, the Delaware Court of Chancery entered an order, certifying a non-opt-out class of Vitalink shareholders for the purpose of the settlement and also approving the notice of the proposed settlement, which advised class members of the settlement hearing and their right to appear at the hearing and object.

At the settlement hearing, a group of stockholders, led by plaintiff Grimes, stated their objections to the settlement. Grimes argued that defendants had breached their duty of care in approving the offer and merger, and breached their duty of candor under Delaware law and federal securities laws.

The Delaware Chancery Court, in a lengthy opinion, rejected the objections and approved the settlement, holding that the alleged nondisclosures were neither material nor misleading, and that the settlement was "fair and reasonable." *See In re Vitalink,* p. 34-35. The Chancery Court then entered an Order and Final Judgment on November 15, 1991, approving the release and settlement, and dismissing the action with prejudice. The release provided in pertinent part:

> *All claims, rights, causes of action, suits, matters and issues, known or unknown,* that arises now or hereafter out of, or that relate to, or that are, were or could have been asserted in connection with [the Offer, the Merger, the Merger Agreement or any of the accompanying disclosures or

related agreements] *are hereby compromised, settled, released and discharged.*

(Emphasis supplied).

In re Vitalink, Order and Final Judgment, p. 2.
Plaintiff Grimes appealed this judgment to the Delaware Supreme Court, which affirmed in *Grimes v. John P. McCarthy Profit Sharing Plan*, No. 468, 1991 (Del. Apr. 30, 1992). Mr. Grimes then filed a petition for certiorari with the United States Supreme Court, which was denied on October 5, 1992. Plaintiffs also filed suit in this court, alleging misleading and inadequate disclosures under federal securities laws and denial of due process in the Delaware action.

DISCUSSION

Standard of Review

Under Federal of Civil Procedure 56(c), summary judgment is proper if "there is no genuine issue as to any material fact and that the moving party is entitled to summary judgment as a matter of law." The inquiry for the court is "whether the evidence presents a sufficient disagreement to require submission to a jury or whether it is so one-sided that one party must prevail as a matter of law." *Anderson v. Liberty Lobby*, 477 U.S. 242, 251-52 (1986). The court does not resolve questions of disputed fact, but simply decides whether there is a genuine issue of fact which must be resolved at trial. *Anderson v. Liberty Lobby*, 477 U.S. at 249.

The Release

Plaintiffs allege that this action is not barred by the release in the Delaware court settlement. First, plaintiffs, as parties to that case, were bound by the release. Plaintiffs were record holders of common stock of Vitalink during the period from May 6, 1991 to July 1, 1991, the effective date of the NSC merger. See Complaint paras. 10-24.

Therefore, they were members of the plaintiff class certified by the Chancery Court. The non-opt-class encompassed not only the plaintiffs, but all Vitalink stockholders, who could be members of the three classes proposed in the action.

The plaintiffs, as class members, received notice of the Delaware proceedings and were provided an opportunity to be heard. Indeed, plaintiff Grimes vigorously exercised this opportunity. Both the Delaware Chancery Court and the Delaware Supreme Court rejected Mr. Grimes' disclosure claims and found the settlement to be fair to the Vitalink stockholders. *See In re Vitalink*, p. 26-35.; *Grimes v. John P. McCarthy Profit Sharing Plan*, p. 1-2. Given these procedural safeguards, the release is binding on the plaintiffs and all other members of the class. *See TBK Partners*, 675 F.2d 456, 460 (2d Cir. 1982); *Walsh v. Great Atlantic & Pacific Tea Co.*, 726 F.2d 956, 962-64 (3rd Cir. 1983).

Plaintiff Holbrook, who chose not to object to the settlement in Delaware, now mistakenly claims that under *In re Real Estate Title & Settlement Servs. Antitrust Litig.*, 869 F.2d 760 (3rd Cir. 1989), *cert. denied*, 493 U.S. 821 (1989), he has a right to relitigate the fairness of the settlement and the certification of the class. That case, however, expressly recognized that a class member may be precluded from relitigating claims in another forum when the class member either has "minimum contacts with the [initial] forum or consent[s] to jurisdiction." 869 F.2d at 769. Furthermore, under Delaware law, in a non-opt-out class action, a state court has jurisdiction over a non-resident stockholder, who purchased stock from a Delaware corporation. *See Hynson v. Drummond Coal Co.*, 601 A.2d 570 (Del. 1990). Here, Mr. Holbrook, a Connecticut citizen, purchased 5,000 shares from Vitalink, a Delaware corporation. Once Mr. Holbrook was subject to the jurisdiction of the Delaware court, he was bound by the release in the Delaware stockholder class action. Thus, the release,

executed under the court-approved settlement, effectively bars later claims arising out of the same transaction, even those by an absent class member like Mr. Holbrook.

Second, the claims set forth in counts one and two—breach of fiduciary duty, Securities and Exchange Act, and fraud—were claims released in the Delaware settlement. Where litigants "manifest an intent to settle all accounts, [a] release will be given full effect" to bar all claims. *Three Rivers Motors Co. v. Ford Motor Co.*, 522 F.2d 885, 896 (3d Cir. 1977). *See Adams v. Jankouskas*, 452 A.2d 148, 155-156 (Del. 1982).[2] Such an intent was manifested by the parties in the Delaware action.

The language in the release evinces an intent to end all disputes between the parties. Further, it contains language similar to the release at issue in *Erie Telecommunications*, where the Third Circuit found that the release was "clear and unambiguous and was obviously meant to put an end to all disputes . . ." *Erie Telecommunications, Inc. v. City of Erie, Pa.*, 853 F.2d 1084, 1097 (3rd Cir. 1988). *See Lowenschuss v. Resorts International, Inc.*, No. 89-1071, 1989 U.S. Dist. LEXIS 7407 (E.D. Pa. June 29, 1989). The claims pressed in this action clearly fall well within the language of the release. That the complaint in this case emphasized federal disclosure laws, whereas the Delaware action placed its emphasis on state fiduciary concepts is inconsequential. The two suits, notwithstanding any differences in remedies sought or theories of recovery pleaded, had a common gravamen: that defendants had made improper and misleading disclosures.

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[2] The question of choice of law has not been raised by the parties. In *Three Rivers*, the Third Circuit applied Pennsylvania law. The decision in *Three Rivers* comports with federal law on releases. *See Macy v. United States*, 557 F.2d 391, 394 (3rd Cir. 1977). Further, the *Three Rivers* decision also comports with Delaware law. See, e.g., *Adams v. Jankouskas*, 452 A.2d 148, 155-56 (Del. 1982).

Plaintiffs also contend that, state law notwithstanding, a Delaware court cannot approve a settlement that has the effect of releasing federal claims which, as a matter of jurisdictional competency, could not themselves have been brought in state court. Although that thesis may indeed appear to have some prima facie logical appeal, it also appears not to be the law. On the contrary, a release that is sufficient as a matter of state law must also pass muster under federal law. *See Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29 (1st Cir. 1991). Yet, as a general matter, federal law allows a state court to approve and enforce a settlement, which requires a party to release claims that could be brought in federal court under "exclusive jurisdiction" statutes. This is so, even though the state court would not have jurisdiction to adjudicate such claims. *See Nottingham Partners*, 925 F.2d at 34; *Lowenschuss v. Resorts International, Inc.*, No. 89-1071, 1989 U.S. Dist. LEXIS 7407 (E.D. Pa. June 29, 1989); *TBK Partners, Ltd. v. Western Union Corp.*, 675 F.2d 456, 460 (2d Cir. 1982). And where, as here, the federal securities claims in the release stemmed from the same nucleus of operative fact as the Delaware state law claims, the release could validly be used as a defense to the former in federal court. *See TBK Partners*, 675 F.2d at 460.

Collateral Estoppel

Plaintiffs' claims are also barred by the collateral estoppel effect of the Delaware judgment. In this action, plaintiffs argue that defendants violated the Securities and Exchange Act, through disclosures they made in connection with the offer and merger. Since plaintiffs' claims arise under the federal securities laws and are cognizable only in federal court, the plaintiffs' action may not be dismissed on grounds of *res judicata*. It is well established, however, that

> [W]here both the state and federal suits are based on the same transactions, collateral estoppel

would apply with regard to the facts determined in the state action.

Bernstein v. Mediobanca Banca di Credito, 78 F.R.D. 1 (S.D.N.Y. 1978), *citing, Abramson v. Pennwood Investment Corp.*, 392 F.2d 759, 762 (2d Cir. 1968). The doctrine of collateral estoppel, or issue preclusion, bars the parties in a later action from relitigating issues of fact conclusively adjudicated in an earlier action. Thus, collateral estoppel can apply to preclude the relitigation here of issues previously litigated in Delaware state court. *See Allen v. McCurry*, 499 U.S. 90, 95 (1980).

In deciding whether the doctrine applies to the case at bar, I must first look at state law to see if issue preclusion flows as a consequence of the previous state court adjudication. 490 U.S. at 96. Delaware follows the usual practice: under Delaware law, a judgment in one case is conclusive in a later (and different) case as to a question of fact actually litigated by the parties and determined in the first action.[3] *See E.B.R. Corp. v. PSL Air Lease Corp.*, 313 A.2d 893 (Del. 1973).

Secondly, I must determine whether the facts found in the Delaware court proceeding, or the release executed there, are sufficient to preclude plaintiffs' from relitigating the disclosure issue in federal court. Here, each of the elements required for issue preclusion is present. First, the Delaware Chancery Court entered an order and final judgment dismissing the Delaware claims. Second, in that action, the plaintiffs and the objectors, including plaintiff

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[3] Further, Delaware does not require mutuality to exist for collateral estoppel to apply, *Columbia Casualty Co. v. Playtex FP, Inc.*, 584 A.2d 1214, 125-17 (Del. 1991), so a party to a valid and final judgment in a Delaware action is bound by the determination of issues in that action in subsequent litigation against non-parties. Thus, the plaintiffs are precluded from relitigating the issues decided in the Delaware action against defendants McCranie, Abbe, Rein, and Altman who were not named as defendants in that action.

Grimes, actually litigated the disclosures accompanying defendants' offer and merger into NSC. The objectors contended, as noted by the Delaware Chancery Court, "that the Board failed to satisfy their duty of candor under Delaware law and their duty not to make material misrepresentations in the offering documents under federal law." *See In re Vitalink*, p. 26. Third, the Delaware Chancery Court made a determination relating to the merits of the objectors' disclosure claims. The Chancery Court thoroughly evaluated these claims under the federal materiality standard in *TSC Industry v. Northway, Inc.*, 426 U.S. 438, 449 (1976), as required under Delaware law, and found no material omissions or misrepresentations. Based, in part, on these findings, the Delaware Chancery Court entered its order and final judgment dismissing the Delaware claims. *See In re Vitalink*, p. 26-32. Thus, plaintiffs are collaterally estopped from arguing here, contrary to what the Delaware courts found, that inadequate disclosures were made, or that the settlement was unfair.

Despite the clear presence of issue preclusion, the plaintiffs attempt to have the court review the propriety of the class certification and settlement. I, however, must give full faith and credit to what the esteemed Delaware Chancery Court has lawfully found and ordered, *see* 28 U.S.C. § 1738 (1988), and will do so.

Procedural Due Process

The Delaware courts, affording all the protections which the Due Process Clause commands, defined a class within whose definitional boundaries plaintiffs fell. Plaintiffs were given, and Mr. Grimes vigorously exercised, a constitutionally adequate opportunity to be heard. They litigated, and lost on, the issues already mentioned; that defendants' disclosures were not materially misleading, and that the settlement was fair and adequate.

Nevertheless, plaintiffs argue that the Delaware courts violated due process, for three reasons. First, plaintiffs

contend that the Chancery Court, in passing upon the settlement, did not apprise itself of all the facts necessary for an objective opinion. Plaintiffs say that the Chancery Court instead merely gave a "boiler-plate approval" of a "sham settlement." Second, plaintiffs say that the Chancery Court failed to make a proper evaluation, before approving the Delaware plaintiffs' application for attorneys' fees. Third, plaintiffs argue that Mr. Grimes received the "run around" when he sought discovery into the settlement negotiations.

With respect to plaintiffs' first contention, the Chancery Court, in its thirty-nine page opinion, carefully and thoroughly evaluated each of the claims in the complaint and by the objectors, and it found them to be "very weak." *See In re Vitalink*, p. 9-31, 34. The court then weighed the value of the released claims against the benefits of the settlement and found the settlement to be fair and reasonable. The court's thoughtful analysis is patently inconsistent with the plaintiffs' assertion that the court ignored, rather than rejected evidence, that the settlement was a sham. Second, the Chancery Courts award of attorneys' fees was proper. It evaluated the quality of the legal services, the contingent nature of the fee, and the standing and ability of counsel. *See Sugarland Industries, Inc. v. Thomas*, 420 A.2d 142, 142-50 (Del. 1980). Third, plaintiffs were not denied discovery nor was plaintiff Grimes given the "run around." Although plaintiffs had at least six weeks' notice of the settlement hearing, they failed to request formal discovery. Thus, plaintiffs' claim that, under *Girsh v. Jepson*, 521 F.2d 153 (3rd Cir. 1975), Mr. Grimes was denied meaningful participation in discovery and the hearing, simply does not jive with the record.

Summary judgment is not granted lightly in any case. But in a proper case—such as this one, in which plaintiffs have not been able to establish that a genuine issue of fact remains to be tried—summary judgment is appropri-

ate. Accordingly, an order will be filed granting defendants' motion for summary judgment and denying plaintiffs' motion for partial summary judgment.

APPENDIX C

Memorandum Opinion of the Court of Chancery of Delaware on Settlement Hearing

IN THE COURT OF CHANCERY
OF THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

Consolidated
Civil Action No. 12085

IN RE VITALINK COMMUNICATIONS CORPORATION SHAREHOLDERS LITIGATION

MEMORANDUM OPINION

Date Submitted: September 16, 1991
Date Decided: November 8, 1991

Joseph Rosenthal, Esquire, of ROSENTHAL, MONHAIT & GROSS, P.A., Wilmington, Delaware; ABBEY & ELLIS, New York, New York, Attorneys for Plaintiffs.

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Gregory P. Williams, Esquire, J. Michael Christopher, Esquire, and Helen M. Richards, Esquire, of RICHARDS, LAYTON & FINGER, Wilmington, Delaware, Attorneys for Objectors.

CHANDLER, Vice Chancellor

Plaintiff, John P. McCarthy Profit Sharing Plan, was a shareholder of Vitalink Communications Corporation ("Vitalink"). On May 9, 1991, plaintiff, alleging breaches of fiduciary duties and the aiding and abetting of the breaches, instituted a class action suit on behalf of all Vitalink common stockholders who were to have their equity interests in Vitalink eliminated because of its merger with Network Systems Corporation ("NSC"). The defendants in this case are Vitalink, Leslie Denend, who was Chief Executive Officer, President and Director of the Vitalink Board of Directors (the "Board") and NSC.

Plaintiff and defendants filed a Stipulation and Agreement of Compromise, Settlement and Release (the "Settlement Agreement") with this Court on July 16, 1991. On July 18, I entered an Order (i) certifying a class of Vitalink's shareholders for the purpose of the settlement and (ii) approving the Notice of Pendency of Class Action, Class Action Determination, Proposed Settlement, Settlement Hearing and Right to Appear (the "Notice"). Pursuant to the Order, the parties mailed the Notice to the members of the class on July 29, 1991.

On September 6, 1991, Charles L. Grimes, John D. Burton, Reed Rubin, Louise I. G. Ireland, Renate Winston (as custodian for Hella Winston), William P. Wood, Jr., Louisa W. Ruby, Charles Kelly, Gadfly Foundation, Inc., Fidelity Bank (as custodian for Gordon W. Chaplin and as custodian for Susan C. Steinberg) (collectively, the "Objectors") filed an objection and a memorandum in opposition to the proposed settlement. On September 16, I held a hearing to determine whether I should approve the Settlement Agreement. This is my decision as to whether I approve the Settlement Agreement.

Part I of this Opinion gives a brief factual history. Part II delineates the class action approval standard. Part III discusses the probable validity of the claims. Part IV

weighs the value of the claims against the value of the settlement. Part V discusses plaintiff's request for lawyers' fees and expenses. Finally, part VI states my conclusions.

I. FACTUAL HISTORY

Vitalink was a corporation duly organized under Delaware law with its principal offices located in Fremont, California. Vitalink was a high-technology company that designed, manufactured, marketed and supported data communications products known as wide area bridges. Vitalink experienced tremendous growth in the late 1980s. By the end of 1989, Vitalink controlled approximately 70 percent of the market and had developed close relationships with many of its 1500 customers.

In early 1990, Vitalink's competitive outlook began to deteriorate. Routers, rather than bridges, became the more desirable interconnect product for many of Vitalink's customers. Vitalink's stock "tumbled from $17 in mid-February to $11 [per share] by the end of the month." (Def. Exh. 15 at N200316.)

In February 1990, the Board engaged Kidder, Peabody & Co., Inc. ("Kidder") to assist in exploring Vitalink's financial and strategic alternatives to the industry's changes. By late April, Kidder had prepared a draft Offering Memorandum that Vitalink would have delivered to any party interested in purchasing it, if it had been finalized. In April 1990, Vitalink instructed Kidder to suspend its efforts related to the exploration of Vitalink's strategic and financial alternatives.

In late October 1990, the Board hired Leslie G. Denend as its new Chief Executive Officer and President. An independent executive search firm had located Denend. Denend had no previous affiliation or financial interest with Vitalink. The Board instructed Denend to familiarize himself with Vitalink, explore the company's alternatives and report his findings.

On December 10, 1990, Denend first met with NSC. NSC is a corporation that designs, manufactures and services high performance data communications equipment which connects mainframe computers, minicomputers and workstations. At the conclusion of this meeting, Denend believed that all business combination discussions with NSC had ended and that NSC would not contact Vitalink again. (Denend Dep. at 13, 29.)

In mid January 1991, Vitalink representatives held a phone conversation with NSC about the possibilities of an original equipment manufacturer ("OEM") relationship. (Denend Dep. at 29.) The proposed relationship would attempt to maximize the value of NSC's router technology and Vitalink's distribution network.

In late January or early February 1991, Vitalink began to hold discussions with another company ("A Co."). (Denend Dep. at 34, 39.) Following this meeting with A Co., Denend held another meeting with NSC. (Denend Dep. at 30.) The topic of this meeting was NSC technology that possibly could be used in an OEM relationship. At the conclusion of this meeting, Denend believed that NSC would not make a proposal for the acquisition of or a business combination with Vitalink. (Denend Dep. at 35, 36.)

On February 12, 1991, Vitalink held a board meeting. At this meeting, the Board considered the possibility of executing change in control employment agreements (the "Control Agreements") with its key employees. (Denend Exh. 4 at V0004172.) Also, Denend summarized his view of Vitalink's business alternatives. (*Id.*)

After this board meeting, Vitalink representatives also held discussions with another company ("B Co."). In all, Vitalink held two meetings and a phone conversation with B Co. Ultimately, B Co. decided that the pursuit of a business combination with Vitalink was not in its best interests because of its goal to pursue an initial public

offering. (Denend Dep. at 20.) B Co. revealed its decision to Vitalink by March 25, 1991. (Valdez Dep. at 64-65.)

On March 5, 1991, Denend signed his Control Agreement. (Denend Exh. 3.) On March 15, 1991, Vitalink met with NSC again. It was at this meeting that Vitalink and NSC decided that an OEM relationship would not be the best way to exploit their respective strengths. (Valdez Dep. at 56; Altman Dep. at 13; Def. Exh. 16 at VA0003517.) Also during March, Vitalink rehired Kidder to explore its strategic alternatives.

In this same time frame (*i.e.*, early spring 1991), Vitalink continued to discuss a possible business combination with A Co. Ultimately, A Co. desired to have a three-way combination with A Co., Vitalink and a third party ("C Co."). Denend believed that such a transaction would take about eight to twelve months to consummate. (Denend Dep. at 21.)

During March and April 1991, Vitalink continued its discussions with NSC. The parties focused their attention on the possibility of a business combination and its form and structure since they had decided that an OEM relationship would not be the most valuable way to structure the relationship between the two entities. (Denend Dep. at 52-53, 58-59, 62.) At the April 9, 1991 Vitalink board meeting, the Board considered the possibility of a business combination with NSC and its probable advantages and disadvantages. (Def. Exh. 24 at VA004212.)

Between April 9 and April 23, Kidder conducted its due diligence as to a possible Vitalink/NSC business combination. On April 23, 1991, the Vitalink Board held a meeting where it determined that it was not realistic to expect another bidder to surface given the outcome of negotiations with A Co., B Co. and C Co. (Def. Exh. 26 at VA004239.) Thus, the Board requested NSC to make a concrete bid. (*Id.* at VA004240.)

Shortly after the Board's April 23 meeting, NSC made its first bid for Vitalink. The offer was a market offer. That is, it basically was an offer to purchase Vitalink at its trading price. The bid was for $7.40 cash and $1 of NSC common stock. Also, NSC conditioned the offer on Vitalink granting NSC an option to buy 19.9% of Vitalink's common stock (the "Lockup"), Vitalink agreeing to not solicit alternative offers ("the "No-Shop") and certain Vitalink officers agreeing to enter into new employment agreements with NSC. At the April 29, 1991 board meeting, the Vitalink Board rejected the offer. (Def. Exh. 25 at VA004244.)

On May 1, 1991, NSC made a second offer to buy Vitalink. NSC increased the consideration offered so as to give a small premium ($.20-$.25 per share). Again, the Board rejected NSC's offer as inadequate.

On May 1, 1991, NSC made a third offer to buy Vitalink. Pursuant to this bid, NSC offered to purchase all Vitalink common stock for $10.50 cash per share. Also, it was subject to the conditions discussed above as applying to the first offer (*i.e.*, the Lockup, No-Shop and employment agreements). On May 5 and 6, the Board met to consider this third offer. On May 6, 1991, the Board accepted NSC's offer, recommended it to Vitalink's stockholders and publicly announced the transaction. The May 6, 1991 closing trading price for Vitalink was $8.50 per share. Thus, the $10.50 offer represented approximately a 23.5% premium over Vitalink's market price.

On May 9, 1991, plaintiff filed this suit with this Court. Pursuant to the terms of the offer, NSC commenced the tender offer on May 13. On May 29-30, the parties executed the Settlement Agreement. The purported consideration given to plaintiff and the class for the execution of the Settlement Agreement was: (1) NSC extended the tender offer for ten days so that it would not close until June 20, 1991; (2) the parties amended their merger agree-

ment so that Vitalink's reimbursement of NSC's fees and expenses was limited to $1.75 million, (3) the parties amended the Lockup so as to limit the cancellation amount payable to NSC to $2,771,331 (the number of Lockup shares multiplied by $1 per share); and (4) the parties agreed to publicly announce the extension of the tender offer and the amendments to their merger agreement and the Lockup.

The tender offer expired on June 20, 1991. At the close of the tender offer, NSC owned approximately 90.7% of Vitalink. The parties consummated the merger on July 1 by performing a short form merger. *See* 8 *Del. C.* § 253. On July 11, 1991, NSC mailed notice to the former stockholders of Vitalink who had not tendered their shares informing them of the consummation of the merger.

As described above, the parties filed the Settlement Agreement with the Court on July 16, 1991. On July 18, I entered an Order certifying a class for the purpose of the settlement and approving the Notice to the class. Pursuant to the Order, the parties mailed the Notice to members of the class on July 29. On September 6, 1991, the Objectors filed an objection and a memorandum in opposition to the proposed settlement. Finally, on September 16, I held a hearing to determine whether I should approve the Settlement Agreement.

II. CLASS ACTION SETTLEMENT APPROVAL STANDARD

As a general matter, Delaware courts have favored the voluntary settlement of lawsuits. *See, e.g., Nottingham Partners v. Dana*, Del. Supr., 564 A.2d 1089, 1102 (1989); *Polk v. Good*, Del. Supr., 507 A.2d 531, 535 (1986); *Rome v. Archer*, Del. Supr., 197 A.2d 49, 53 (1964); *Braun v. Fleming-Hall Tobacco Co., Inc.*, Del. Supr., 92 A.2d 302, 309-310 (1952). Further, Delaware courts have favored the settlement of class actions in particular because the set-

tlements promote the interest of judicial economy. *See generally In re MAXXAM Group, Inc. Stockholders Litig.*, Del. Ch., C.A. No. 8636, Allen, C. (Apr. 16, 1987), slip op. at 2; *Amsellem v. Shopwell, Inc.*, Del. Ch., C.A. No. 5683, Hartnett, V.C. (Sept. 6, 1979), slip op. at 5.

As far as the standard that I must use in deciding whether to approve the settlement, this Court consistently has held that:

> [a] motion of this sort requires the court to exercise a judgment of its own as to the fairness and adequacy of the proposed settlement. *Polk v. Good*, Del. Supr., 507 A.2d 531 (1986); *Rome v. Archer*, Del. Supr., 197 A.2d 49 (1964). In doing so, the court acts on behalf of the absent class members and seeks to protect and advance their interests . . . . The burden rests upon those proposing the settlement to persuade the court that it is fair and reasonable in all of the circumstances.

In re Amsted Industries Inc. Litig., Del. Ch., Cons. C.A. No. 8224, Allen, C. (Aug. 24, 1988), slip op. at 3. *Accord In re Resorts Int'l Shareholders Litig.*, Del. Supr., 570 A.2d 259, 266 (1990); *Polk*, 507 A.2d at 535; *Friedman v. Baxter Travenol Laboratories, Inc.*, Del. Ch., C.A. No. 8209, Jacobs, V.C. (Feb. 18, 1986), slip op. at 6. Indeed, the status of this suit as a non-(b)(3) class action heightens the standard even further since this type of class action affords the members no opportunity to opt out. *See In re Amsted Industries Inc. Litig.*, *supra*, at 1.

In exercising its business judgment and applying this heightened standard, it is not necessary for the Court to decide the merits of the case. *See Barkan v. Amsted Industries, Inc.*, Del. Supr., 567 A.2d 1279, 1284 (1989); *Rome*, 197 A.2d at 53; *In re Beatrice Companies, Inc. Litig.*, Del. Ch., C.A. No. 8248, Allen, C. (Apr. 16, 1986), slip op. at 2, *aff'd*, Del. Supr., 522 A.2d 865 (1987). How-

ever, the Court must consider a number of factors. These factors include:

> (1) The probable validity of the claims, (2) the apparent difficulties in enforcing the claims through the courts, (3) the collectibility of any judgment recovered, (4) the delay, expense, and trouble of litigation, (5) the amount of the compromise as compared with the amount and collectibility of a judgment, and (6) the views of the parties involved, pro and con.

Polk, 507 A.2d at 536. *Accord In re First Boston, Inc. Shareholders Litig.*, Del. Ch., C.A. No. 10338, Allen, C. (June 7, 1990), slip op. at 1; *In re MAXXAM Group, Inc. Stockholders Litig.*, *supra*, at 2. In this case, the parties' primary disputes rest upon factors (2) and (5): the probable validity of the claims and the amount of the compromise as compared with the probable amount of a judgment for the claims.

III. PROBABLE VALIDITY OF THE CLAIMS

At the outset, I note that the Objectors do not claim that Vitalink's Board breached its fiduciary duty of loyalty. Further, to the extent that plaintiff's initial complaint alleged a breach of the fiduciary duty of loyalty, I firmly believe that any such loyalty claim is wholly meritless. I believe that any loyalty claim is meritless because Vitalink's Board unanimously approved the transaction, because three of Vitalink's four board members were completely disinterested (and, therefore, the entire Board is deemed "disinterested", *see Aronson v. Lewis*, Del. Supr., 473 A.2d 805, 812 (1984)) and because there is no evidence that an interested party "controlled" the actions of the Board. *See generally id.*; *Roberts v. General Instrument Corp.*, Del. Ch., C.A. No. 11639, Allen, C. (Aug. 13, 1990), slip op. at 17.

A. Duty of Care

1. Duty and Standard of Review

When the Board determined to sell Vitalink, its duty of care changed from a duty to preserve the company to a duty to attain the highest price reasonably attainable for Vitalink's stockholders under the circumstances. *See Barkan*, 567 A.2d at 1286; *Mills Acquisition Co. v. Macmillan, Inc.*, Del. Supr., 559 A.2d 1261, 1288 (1989); *Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc.*, Del. Supr., 506 A.2d 173, 182 (1986). Having determined the duty of the Board, I must determine the standard I would use at trial to decide whether the Board fulfilled their duty.

> In each instance where the board is not predominantly self-interested or under the control or dominating influence of a person with a conflicting interest, the principal judicial inquiries relate to whether the board was adequately informed and acting in good faith. This court has been pointedly instructed, however, that "where issues of corporate control are at stake" action of even a disinterested board must meet an enhanced test before they will qualify for the deference that courts ordinarily accord to good faith business judgments. *See Mills Acquisition Co. v. Macmillan, Inc.*, Del. Supr., 559 A.2d 1261, 1287-88 (1989). This enhanced test requires a judicial judgment of reasonableness in the circumstances .... In such a setting, the additional level of inquiry comes to this: whether the circumstances afford a disinterested and well motivated director a basis reasonably to conclude that if the transactions contemplated by the merger agreement close, they will represent the best available alternative for the corporation and its shareholders.

Roberts, supra, at 17-18. Thus, the question boils down to this: did the Board have a reasonable basis to conclude that the NSC offer was the best available alternative to the corporation and its stockholders?

In this case, the Vitalink Board was considering only one offer when the members made their decision. Thus, the Board must have had a body of reliable evidence upon which to judge the adequacy of the NSC bid or must have canvassed the market to determine if it could have elicited higher bids in order to satisfy the enhanced reasonableness test described in *Roberts*. *See Barkan*, 567 A.2d at 1286-87. The Objectors claim that the Vitalink Board neither had canvassed the market to determine if it could have elicited higher bids nor had a sufficient body of reliable evidence to judge the adequacy of the bid. On the other hand, defendants argue that the Board canvassed the market and had a sufficient body of reliable evidence.

2. Canvassing the Market

From December 1990 until May 1991, Vitalink held extensive negotiations with NSC as to entering into some sort of business relationship or combination with NSC. Besides the NSC negotiations, the Board also considered whether it should conduct a public auction. However, the Board, with Kidder's advice, determined that an auction could have disastrous effects on Vitalink's competitive position. (Rein Dep. at 137-39; Valdez Dep. at 58, 173-74; Valdez Aff. ¶ 17.) The Board followed this advice even though supposedly everyone knew Vitalink was ready to make a deal. (Rein Dep. at 109.) Further, the Board considered contacting a number of technologically compatible companies but decided against it for various reasons. (See Rein Dep. at 109, 137-88; Valdez Dep. at 76.)

As stated earlier, the Board was in actual contact with A Co., B Co. and C. Co. during the spring of 1991. Ultimately, Vitalink held two meetings and a phone conversation with B Co. before B Co. indicated that it was not

interested in pursuing further negotiations regarding a business relationship or combination. (Denend Dep. at 20-21.) The Board decided not to pursue a transaction with A Co. and C Co. because they believed it would be highly complex and because they believed A Co. and C Co. had to enter into a first step transaction before Vitalink could enter the picture and, until that happened, further negotiations were meaningless. (Rein Dep. at 111-18.) Kidder advised Vitalink that it was doubtful that any other company would have an interest in pursuing a business combination transaction with Vitalink given its poor competitive position. (Valdez Aff. ¶ 22; Def. Exh. 29 at VA004257-58.)

The Objectors argue and I agree that defendants' and plaintiff's briefs contain a lot of smoke and little fire. That is, defendants and plaintiff focus on the Board's considering contacting many companies. However, when the smoke clears, the Board actually held discussions only with three entities in the context of two alternative transactions (*i.e.*, a transaction with B Co. and a three-way transaction with A Co. and C Co.) Further, I am disappointed with defendants' attempts to imply that the Board actually contacted more than these three companies when the record does not support such assertions.[1]

The Objectors also argue that the No-Shop clause, the Lockup and the termination fee prevented Vitalink from being capable of canvassing the market. Defendants argue, and I agree, that these provisions do not, in themselves,

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[1] For example, on page 35 of defendants' brief, defendants assert that Vitalink met with D Co. and refer to their brief at page 14. On page 14 in discussing Vitalink's relationship with D Co., defendants' brief refers to Rein's deposition at 143 and defendants' exhibit 24 at 4213. Both references only state that the Board considered contacting D Co. I see no authority in the record to support defendants' assertion that Vitalink held discussions with D Co. and the effort to create the impression of such discussions based on nonexistent authority is troubling to me.

prevent a company from canvassing the market. *See generally In re Fort Howard Corp. Shareholders Litigation*, Del. Ch., C.A. No. 9991, Allen, C. (Aug. 8, 1988), slip op. at 32 (where court held a lockup option and a window shopping clause did not prevent a market check), *appeal denied*, Del. Supr., 547 A.2d 633 (1988). The No-Shop agreement was subject to a fiduciary out clause whereby the Board could shop the company so as to comply with, among other things, their *Revlon* duties (*i.e.*, duty to get the highest price reasonably attainable for shareholders.) Also, the Lockup did not constitute a real impediment to an offer by a third party. (*See* Valdez Dep. at 137.) Finally, the parties ultimately agreed to limit the termination fee to $2,771,331. This amount represented $1 per share for each of the Lockup option shares. If this amount is spread across 100% of Vitalink's shares, it represents $.199 per share or a little less than 1.9% of the value of the transaction. I do not believe this possible payment prevented a canvass of the market. *See generally Roberts, supra*, at 21 (where the Court held that a 2% breakup fee was limited); *Braunschweiger v. American Home Shield Corp.*, Del. Ch., C.A. No. 10755, Allen, C. (Oct. 26, 1989), slip op. at 19 (where the Court heid that a $.25 per share cancellation fee was not onerous).

Ultimately, in determining whether the Board canvassed the market, I have considered a number of factors. First, Vitalink held discussions with three companies besides NSC in the context of two transactions alternative to the NSC transaction. Although these discussions gave an indication as to the extent of the market's interest with Vitalink at any price, the discussions gave little indication as to the adequacy of the NSC bid because negotiations with these companies broke off before the parties ever discussed valuation issues. (Denend Dep. at 26-27.) Second, the discussions were somewhat contemporaneous with the NSC agreement. That is, the discussions with these three companies concluded by mid-March 1991 and were sufficiently

close to the May agreement so that the timing of the discussions, in itself, did not jeopardize whatever information the discussions provided as to the adequacy of the NSC bid. Third, the Lockup option, the No-Shop clause and termination fees did not prevent, in themselves, a canvass of the market. Finally, forty-five days passed between the public announcement of the transaction and the closing of the tender offer. In this period, no bidder came forward.

The goal of the canvassing requirement is to ensure that a board has adequately informed itself as to whether it is getting the best deal reasonably possible for the shareholders. After considering the factors enumerated earlier, I am persuaded that the actions of the Board were not an effective probe of the market and did not provide the Board sufficient information to judge the adequacy of the NSC bid. The Board's actual contacts with other companies only indicated that some members of the market were unable or unwilling to enter into a transaction with Vitalink at any price. Further, I refuse to rely principally upon the market test as constituting a canvass of the market for two reasons. First, I refuse to rely on it because the term canvass connotes greater action by the Board than an implicit market test. Second, I refuse to rely principally on the implicit market test as constituting a canvass of the market because of my heavy reliance on this factor in deciding that the Board had a sufficient body of reliable evidence to judge the adequacy of the NSC bid. That is, if I also rely on it here, it will be difficult to distinguish between the two tests. Thus, I hold that the actions of the Board did not constitute a canvass of the market.

3. Body of Reliable Evidence

With respect to the issue whether the Board had a sufficient body of reliable evidence upon which to judge the adequacy of NSC's bid, the first element the Board relied

upon was the Kidder fairness opinion as to the proposed transaction with NSC. In deciding that the transaction would be fair to Vitalink, Kidder performed three types of valuation analyses: a discounted cash flow analysis, a comparable transaction analysis and a comparable company analysis.

The Delaware courts have affirmed the validity of the discounted cash flow method of valuation repeatedly. *See Cede & Co. v. Technicolor*, Del. Ch., C.A. No. 7129, Allen, C. (Oct. 19, 1990), slip op. at 17; *Neal v. Alabama By-Products Corp.*, Del Ch., C.A. No. 8282, Chandler, V.C. (Aug. 1, 1990), slip op. at 21, *aff'd*, Del. Supr., 588 A.2d 255 (1991).

> The DCF model entails three basic components: an estimation of net cash flows that the firm will generate and when, over some period; a terminal or residual value equal to the future value, as of the end of the projection period; and finally a cost of capital with which to discount to a present value both the projected net cash flows and the estimated terminal or residual value.

Cede & Co., supra, at 17-18.

In this case, Kidder's discounted cash flow analysis valued Vitalink between $9.50 and $11.75 per share. In evaluating a discounted cash flow analysis, the quality of the projections relied upon is central to the reliability of the underlying methodology. *See Harris v. Rapid-American Corp.*, Del. Ch., C.A. No. 6462, Chandler, V.C. (Oct. 2, 1990), slip op. at 15. In preparing their analysis, Kidder relied upon information that was overly optimistic: the projected revenue growth was dependent on new product development that was no longer on schedule. (*See* Objectors' Exh. B at 6.)

The Objectors attack Kidder's discounted cash flow analysis because of its reliance on these overly optimistic pro-

jections. This attack is completely meritless. The use of the overly optimistic projections, if anything, overvalues Vitalink. Thus, since NSC's bid rests within the value range even using the overly optimistic projections, the use of this methodology is a very strong indication as to the adequacy of the NSC bid.

The Objectors also attack Kidder's discounted cash flow analysis by contending that Kidder manipulated the discount rate and the terminal multiple it used. That is, Kidder used a 14% discount rate and terminal multiples of 10, 12 and 14 in its April 1990 analysis. In its June 1990 analysis, Kidder again used a 14% discount rate and terminal multiples of 14. (Valdez Dep. Exh 2 at KP001884.) However, Kidder used terminal multiples ranging from 3-6 and discount rates from 18-22% in its May 1991 analysis. (Valdez Dep. Exh. 10 at KP000048.)

The Objectors take issue not so much with the correctness of these numbers but with the failure of the Board to question Kidder's changes. The defendants and plaintiff contend, and I agree, that the changes Kidder made were appropriate. Vitalink was a very different company in May 1991 than it was in February and April 1990. "In February of 1990 the company was growing, the company still had market share, which would be termed significant. In March 1991 the company's revenues were declining. The company's market share within the broader context of the industry was also declining." (Valdez Dep. at 19-20.) Vitalink was a much riskier company in May 1991 than in February and April 1990. (*Id.*) Thus, Kidder's adjustments to account for these differences were appropriate.

The failure of Vitalink's Board to question Kidder regarding the changes is irrelevant. At this juncture, the issue only is whether the Board had reliable information upon which to judge whether the NSC bid was the best offer reasonably attainable. The failure to inquire as to why Kidder made the adjustments makes no difference

because, in fact, the adjustments were appropriate and the discounted cash flow analysis constituted reliable information. Further, in all likelihood, the Board thought, as I do, that the reason for the changes was obvious: the severe downturn in Vitalink's prospects.

The second valuation method Kidder used in determining the fairness of the transaction was the comparable transaction method. This method identifies transactions comparable with the one at hand and adjusts the value of those transactions to account for the differences between the companies in the prior transactions and the companies in the pending transaction.

In this case, Kidder's comparable transactions analysis valued Vitalink between $12.27 and $21.02 per share. However, Kidder downplayed the reliability of this methodology because it relied on transactions from the late 1980s where values were high and financing was readily available and because it relied on transactions for growing companies as opposed to companies like Vitalink that were declining. (Objectors' Exh. B. at 6.)

The differences in the economic condition of the takeover market between the late 1980s and present are obvious. Thus, reliance on transactions from that era clearly overvalue the Vitalink transaction. The question then becomes to what extent did the comparable transactions analysis overvalue the Vitalink transaction. However, Kidder did not indicate nor did the Board inquire as to the extent of the method's overvaluation.

The failure of the Board to inquire and of Kidder to determine the extent of the overvaluation undermines defendants' argument that the Board had sufficiently reliable information to determine the adequacy of NSC's bid. The Board or, in its stead, Kidder should have accounted fully for the bid's seeming inadequacy under this analysis. Without this inquiry, a cloud of doubt as to the adequacy

of NSC's bid remained on Kidder's analysis. The Board should have *fully* accounted for this cloud.

The final valuation method that Kidder used was the comparable company analysis. This Court has affirmed the general validity of this approach repeatedly. *See Harris, supra*, at 21. This method first identifies comparable publicly traded companies. *See id.* at 19-20. It then calculates the value of the company to be valued through the application of earnings and other multiples to the comparable companies and the company to be valued. *See id.*

Under the comparable company method, Kidder determined Vitalink's value to be between $7.14 and $11.49 per share. The Objectors first attack Kidder's comparable company analysis by pointing out that Salomon Brothers ("Salomon"), NSC's investment banker, failed to use this method in valuing Vitalink. However, the mere non-use by Salomon of this method is irrelevant. As noted earlier, the Delaware courts have affirmed the validity of this approach repeatedly. The failure of one investment banker to use the methodology, in itself, is not an indication that it was an unreliable method of valuing the pending transaction.

The Objectors next contend that Kidder's comparable company valuation is flawed because it excluded four "upper tier" companies from its analysis and, yet, included the lower than "lower tier" companies. (*See* Valdez Exh. 10 at KP000064.) Defendants argue and I agree that the exclusion of the upper tier companies by Kidder was appropriate. Obviously, the utility of a comparable company approach depends on the similarity between the company the court is valuing and the companies used for comparison. *See Neal v. Alabama By-Products Corp.*, Del. Ch., C.A. No. 8282, Chandler, V.C. (Aug. 1, 1990), slip op. at 21 n.6, *aff'd*, Del. Supr., 588 A.2d 255 (1991); *Citron v. E.I. DuPont de Nemours & Co.*, Del. Ch., 584 A.2d 490, 510 (1990). The exclusion of noncomparable companies makes this type of valuation analysis more reliable. In this

case, Vitalink clearly had become a lower tier company. Vitalink's revenues and earnings were falling quickly in late 1990 and early 1991. Further, despite Vitalink's strong customer base, its outlook was bleak. (Def. Exh. 17 at KP001708; Rein Dep. at 104.) The exclusion of the upper tier companies from its analysis made Kidder's analysis more reliable.

The Objectors contend that if Kidder properly excluded upper tier companies, it also should have excluded companies they allege to be lower than the lower tier companies. The Objectors argue that these lower than the lower tier companies were noncomparable with Vitalink because of the differences in income. (*See* Objectors' Brief at 24.) However, income is not the only factor that determines the comparability of companies. A court can consider many factors in determining the comparability of companies. Such factors include product mix, revenue, revenue and earnings growth rates, assets and geographic markets. The Objectors do not attempt to distinguish Vitalink from the lower than the lower tier companies on the basis of any factor except income. In my opinion, given the Objectors' ability to cite only differences in income and given Vitalink's bleak outlook, Kidder's inclusion of all of the lower tier companies and not the upper tier companies was appropriate.

Kidder used these three valuation methods (*i.e.*, the discounted cash flow analysis, comparable transactions analysis and comparable company analysis) as the primary basis for opining that the proposed transaction with NSC was fair to Vitalink. Despite the infirmities of its comparable transaction valuation, overall, I believe that Kidder's fairness opinion constituted reliable information upon which the Board partially could judge the adequacy of NSC's offer.

Besides Kidder's fairness opinion the Board relied on a number of other factors in deciding that NSC's bid was

the best bid available. Before accepting NSC's third bid, the Board rejected two offers it thought were inadequate. Additionally, NSC conditioned its offer on the granting of the Lockup. (Def. Exh. 28 at VA004253; Altman Dep. at 44.) NSC also conditioned its offer on the execution of the Control Agreements. (Altman Dep. at 30-32.) Moreover, the Board believed that NSC's final offer was "about as close to a turned-inside-out-pocket offer [as Vitalink was] going to get." (Rein Dep. at 186.) Further, the bid represented approximately a 23.5% premium over market price. Also, Kidder's preliminary analysis indicated that $10 per share represented a good price. (Valdez Dep. 124-126; Valdez Aff. ¶ 21.) Further, Vitalink had constructed Kidder's fee arrangement so that Kidder would be paid more if a third party (*i.e.*, not NSC) consummated the merger with Vitalink. Thus, Kidder's failure to get such a third party to consummate the merger is, in itself, an indication that no other bidder would have paid more than $10.50 per share. Similarly, the final factor upon which the Board relied in determining the adequacy of NSC's bid was a market test administered by the circumstances. "[W]hen it is widely known that some change of control is in the offing and no rival bids are forthcoming over an extended period of time, that fact is supportive of the board's decision to proceed." *Barkan*, 567 A.2d at 1287. In this case, forty-five days passed between the time the parties first publicly announced the transaction (May 6, 1991) and the closing of the tender offer (June 20, 1991) without even an inquiry from an interested acquiror. (Valdez Aff. ¶ 34.)

The Objectors contend that the Board's reliance on this last factor, the implicit market test, is meritless. They argue that no potential bidder came forward because of NSC's Lockup and because of the No-Shop clause. However, Valdez testified that the Lockup "was not an insurmountable barrier for another alternative buyer to slip forward." (Valdez Dep. at 137.) Also, the No-Shop clause

was subject to a fiduciary out clause. (Rein Exh. 2 at 10.) I agree with defendants' arguments that the Lockup option and the No-Shop clause were, at best, minimal impediments to an implicit market test.

In making its argument that the Board did not have a sufficient body of reliable evidence upon which to judge the adequacy of NSC's bid, the Objectors also argue that the Board breached their duty of care by failing to determine the inherent value of Vitalink before accepting the NSC offer. The Objectors contend that this ignorance resulted in the Board not having an adequate basis to determine whether NSC's bid was the best offer reasonably possible. *See generally In re Trans World Airlines, Inc. Shareholders Litig.*, C.A. No. 9844, Allen, C. (Oct. 21, 1988), slip op. at 11, 18.

In *TWA*, the special committee basically did not know that its duty was to attain the best offer reasonably possible. *See id.* at 8-9. Further, to the extent the special committee did know they had such a duty, they thought its financial advisor would fulfill it. *Id.* at 10. However, the financial advisor believed its duty was only to address the issue of the offer's fairness. *Id.* Finally, in deciding whether the offer was fair, the financial advisor relied on a number of valuation techniques that resulted in a broad range of values ($14.50 to $66.29 per share) without expressing to the committee how it used the different valuation results in concluding that the offer was fair. *Id.* at 11.

The focus of the *TWA* decision was not so much whether the special committee knew the company's inherent value per se but whether the special committee had sufficient information to satisfy its duty to attain the highest price reasonably possible for the shareholders. I realize that the Vitalink Board did not have perfect information. Nevertheless, I hold that the Vitalink Board had sufficient information so as to satisfy the concerns of the Court in

TWA. Further, although the circumstances in which a body of reliable evidence exists is limited, *see Barkan*, 567 A.2d at 1287, I hold that this same information constituted a body of reliable evidence upon which the Vitalink Board could judge the adequacy of NSC's bid.

This body of information which I hold as sufficient to satisfy *TWA* and as constituting a body of reliable evidence consists of a number of elements. First, the parties negotiated for a number of months over the terms and structure of their relationship. Second, the Board rejected two bids before accepting NSC's third offer. Third, the Board believed that this was NSC's best offer. (Rein Dep. at 186.) Indeed, NSC conditioned its offer on the granting of the Lockup. (Def. Exh. 28 at VA004253; Altman Dep. at 44.) Also NSC conditioned its offer on the execution of the Control Agreements. (Altman Dep. at 30-32.) Fourth, the offer represented approximately a 23.5% premium over Vitalink's trading price. Fifth, Vitalink structured Kidder's fee agreement so that it had an incentive for Vitalink to consummate the transaction at the highest possible price. (*See* Def. Exh. 31 at KP000576.) These five elements afforded a reasonable basis for the Board to conclude that it was getting NSC's best bid.

In holding that the Board had a reasonable basis to conclude that NSC's last offer was the best overall offer, I rely on a number of other factors besides the factors enumerated above. First, Kidder produced a range of Vitalink's fair values ($7.14 to $21.02 per share). This range was much more limited than the range presented to the special committee in *TWA*. Second, Kidder's preliminary analysis indicated that a $10 per share price was a good price. (*See* Valdez Dep. at 124-27; Valdez Aff. ¶ 21.) Third, Kidder opined that the $10.50 price was fair. Fourth, the Vitalink Board and Kidder believed no other bidder was interested. Fifth, Vitalink structured its fee agreement with Kidder so that Kidder had an incentive to have Vitalink consummate a sale with a third party. Finally, and most

importantly, no third party even inquired as to making a competing bid.

Ultimately, I believe that all of these factors combine to allay the Court's concerns in *TWA* over whether a board sufficiently knows its duty and has a sufficient basis to conclude that it has satisfied its duty. Correspondingly, I find that these factors constituted a body of reliable evidence such that the Vitalink Board could reasonably conclude that it was getting the best deal possible for Vitalink's shareholders. Thus, I conclude that the Vitalink Board satisfied its duty of care by having reliable grounds upon which to judge the adequacy of NSC's offer.

B. Duty of Candor

The Objectors argue that the Board failed to satisfy their duty of candor under Delaware law and their duty not to make material misrepresentations in the offering documents under federal law. In making these assertions, the Objectors first contend that the Offer to Purchase and the Schedule 14D-9 did not discuss or summarize Kidder's valuation analysis and its limitations nor did they contain a summary of the various valuation ranges that Kidder calculated. The Objectors argue that defendants' subsequent inclusion of such information in the Notice of Merger was an implicit admission as to the information's materiality. The Objectors' second contention is that the Board violated its disclosure duties by failing to inform the stockholders that they were not soliciting bids from third parties. Finally, the Objectors take issue with the deletion of the sentence: "[w]e have not been represented to, and did not solicit third party indications of interest in acquiring all or any part of the Company." (Objectors' Exh. D at KP000571.) The Objectors argue that the deletion of this sentence from the Kidder opinion that Vitalink sent to its shareholders was inappropriate.

Defendants and plaintiff argue that the Objectors' contentions as to the failure to fully disclose Kidder's opinion

are meritless. Defendants contend that Kidder advised the Board that the range of fair values produced by the comparable transaction analysis was overstated. Defendants argue that the analysis was misleading because it overstated Vitalink's value. Thus, defendants argue it was not material. Similarly, the Board concluded that Kidder's discounted cash flow analysis produced an overly optimistic result because Kidder based its analysis on product development that was behind schedule. Defendants argue that the analysis was misleading because it overstated Vitalink's value. Thus, defendants argue it was not material. Finally, defendants argue that the Board concluded that Kidder's comparable company analysis produced a result that only confirmed the Board's and Kidder's opinions and would not have changed the total mix of information sent to the shareholders had it been disclosed. Thus, defendants argue, it was not material.

Plaintiff and defendants failed to address the Objectors' second disclosure argument. However, defendants argue that the Objectors' third argument regarding the deletion of the sentence in the Kidder opinion is meritless. Defendants argue that they deleted the sentence in order to remove any suggestion that Kidder did not concur with the Board's decision not to pursue offers from third parties while negotiating with NSC. Defendants argue that the deletion was not misleading.

Before I address the specific arguments, I first must discuss the disclosure standards. Materiality exists when:

> the omitted fact would have assumed actual significance in the deliberations of the reasonable shareholder. Put another way there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the total mix of information available.

Rosenblatt v. Getty Oil Co., Del. Supr., 493 A.2d 929, 944 1985) (quoting *TSC Industries Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976)). An entity need not disclose a financial advisor's underlying facts and analyses in every case. *See In re Dataproducts Corp. Shareholders Litig.*, Del. Ch., C.A. No. 11164, Jacobs, V.C. (Aug. 22, 1991), slip op. at 16-17. In deciding whether a court should require disclosure of this type of information, a court should weigh the potential benefits of the disclosure against its potential harm. *See Weinberger v. Rio Grande Industries Inc.*, Del. Ch., 519 A.2d 116, 126-27 (1986). Further, "[t]o be the subject of a disclosure obligation, information relating to value must be considered reliable." *Van de Walle v. Unimation, Inc.*, Del. Ch., C.A. No. 7046, Jacobs, V.C. (Mar. 6, 1991), slip op. at 37.

At the outset, I note that I do not agree with the Objectors' assertion that the subsequent disclosure of the underlying details of the Kidder opinion in the Notice of Merger acted as an implicit admission of its materiality. There are many possible reasons why the disclosure was only included in the later disclosure (*e.g.*, the Board may have not believed it was material but was overly cautious as to what disclosures to make after it had some time to think about this lawsuit). The Objectors have failed to persuade me that the subsequent disclosure was made because the Board believed it was material.

As to the Objectors' arguments regarding defendants failure to disclose Kidder's valuation techniques, analyses and limitations, I agree with defendants that the nondisclosure of Kidder's discounted cash flow analysis and range of value ($9.50 to $11.75 per share) was proper. The nondisclosure was proper because the analysis was not material. The analysis was not material because its potential benefit was, at best, minimal: to act as a mere affirmance to the shareholders of the Board's message that this was a very good deal. However, its potential harm was great. Even if the disclosure included a sentence explaining why

the analysis was overly optimistic, it could have misled shareholders into believing that a higher price was attainable. That is, because the Board did not know the extent of the overstatement and, therefore, could not have disclosed the extent of the overstatement, the shareholders could have read the disclosure and reasonably believed that even if $11.75 was not attainable, a price higher than $10.50 was reasonably attainable when all of the circumstances indicated that this was not the case. Since I believe the potential harm of the disclosure of this analysis outweighs its potential benefit, the Board did not have to disclose it. *See Weinberger*, 519 A.2d at 126-29.

I also agree with defendants that disclosure of Kidder's comparable transaction analysis would have been inappropriate. Clearly, the analysis produced an unreliable range of values ($12.27 to $21.02 per share) because Kidder based its analysis on market conditions that have changed drastically. Disclosure of this analysis would have presented an enormous potential for harm to the shareholders. Even if the disclosure included a sentence why Kidder believed the analysis produced an inflated range, it could have mislead shareholders into believing that a higher price was attainable. That is, because the Board did not know the extent by which the range was inflated and, therefore, could not have disclosed it, the shareholders could have read the disclosure and reasonably believed that even if $21.02 per share was not attainable, a price higher than $10.50 per share was reasonably attainable when all of the circumstances indicated that this was not the case. Further, Kidder gave little or no weight to this analysis in its opinion. (*See* Valdez Aff. ¶ 25.) Thus, it was proper for the Board to not disclose this analysis. *See generally Van de Walle, supra*, at 37 (where court held that unreliable information cannot be the object of a disclosure obligation); *In re Genentech, Inc. Shareholders Litig.*, Del. Ch., C.A. No. 11377, Chandler, V.C. (June 6, 1990), slip op. at 19 (where court relied, in part, on the fact that the investment banker did

not give any serious consideration to certain valuation ranges in determining that the company did not have to disclose them); *Weinberger*, 519 A.2d at 527-30 (where court held that the potential benefits of a disclosure must be weighed against its potential harm and where court relied, in part, on the fact that the investment banker gave little or no weight to a valuation analysis in determining that it was unreliable and did not have to be disclosed.)

I also agree with defendants' claim that the disclosure of the comparable company range of fair value ($7.14 to $11.49 per share) was not necessary. I am not persuaded that disclosure of this analysis would have changed the total mix of information received by the shareholders. Also, it is necessary to draw a line somewhere or else disclosures will become so voluminous that they no longer serve their purpose. *See TCG Securities, Inc. v. Southern Union Co.*, Del. Ch., C.A. No. 11282, Chandler, V.C. (Jan. 31, 1990), slip op. at 18. Thus, I hold that the comparable company analysis falls outside of this line of materiality.

As to the Objectors' second disclosure argument that the Board should have disclosed that it did not canvass the market, I hold that this disclosure was not necessary. The reason for the canvassing requirement is to ensure that a board is getting the best deal possible for the shareholders. *See Barkan*, 567 A.2d at 1287. However, a court can also be so ensured when a board has a reliable body of evidence with which to evaluate the fairness of a transaction. *See id.* I have held earlier that, even though the Vitalink Board did not canvass the market, the Board did have such a body of reliable evidence. Thus, the Board has proven that it has satisfied its duty to get the best deal reasonably possible for the shareholders. It is irrelevant by which route (*i.e.*, the canvass route or the body of reliable evidence route) the Board proved that it satisfied its duty. Therefore, I hold that the Board's non-

canvassing was immaterial and did not have to be disclosed.

As to the Objectors' third contention that the deletion of the sentence from the Kidder opinion sent to shareholders was inappropriate, I agree with defendants that the deletion was not improper. The deletion helps to remove any suggestion that Kidder did not agree with the Board's decision not to pursue third party offers. Further, the edited version of the opinion does not suggest or imply in any way that Kidder was requested to solicit third party offers. Thus, the deletion of the sentence was not misleading and, therefore, not improper.

C. Aiding and Abetting Claims Against NSC

Plaintiff's original complaint included claims against NSC for aiding and abetting the alleged wrongdoings of the Vitalink Board. The Objectors do not contend nor is there any evidence that these claims are meritorious.

IV. WEIGHING THE VALUE OF THE SETTLEMENT AGREEMENT AGAINST THE VALUE OF THE CLAIMS

The second major facet of the parties' arguments deals with the value of the Settlement Agreement as compared to the value of the claims. The Settlement Agreement between plaintiff and defendants called for: (1) NSC to extend the tender offer for ten days until June 20, 1991; (2) NSC and defendants to amend the cancellation agreement under the Lockup so as to limit the cancellation amount payable to NSC to $2,771,331 ($1 per share for each Lockup share); (3) NSC and defendants to amend the merger agreement so as to limit Vitalink's reimbursement of NSC fees and expenses to $1,750,000; and (4) NSC and defendants to publicly announce the agreements stated in (1)-(3).

The Objectors argue that the purported benefits conveyed by the Settlement Agreement are wholly illusory.

They argue that the extension of the tender offer conveyed no benefit because there was no expectation that a third party offer would arise and because the Lockup option and the No-Shop acted as a severe impediment to such offers. They also argue that the amendments to the Lockup option and termination agreements were illusory because the Lockup and the No-Shop acted as a severe impediment to the amendments ever becoming operative. Further, assuming that the Lockup and No-Shop did not act as an impediment to third party offers, the Objectors argue that the amendments to the cancellation amount payable and reimbursement agreement were illusory because any potential third party offer would have come forward already and made his bid. Also, the limitations on these amendments, they argue, were illusory in themselves because the parties did not know whether they would be exceeded if they became payable.

The extension acted to enhance Vitalink's market check and to add to the Board's body of reliable evidence that this was the best deal reasonably attainable for the shareholders. As discussed earlier, the Lockup option and No-Shop acted as no real impediment to third party offers. Thus, the extension of the tender offer provided some benefit to Vitalink's shareholders.

As far as the amendments to the cancellation agreement and reimbursement agreement, the Lockup and No-Shop acted as no real impediment to a third party offer. Thus, the amendments could have become operative. Further, the amendments were not illusory because the parties did not expect a third party offer to arise. That is, just because the parties did not expect a third party offer did not mean that one could not arise. Finally, just because the parties did not know whether the limitation amounts would be exceeded does not mean they could not have been exceeded. Indeed, if NSC expended more than $1,750,000 on its expenses and required more than $2,771,331 for its Lockup cancellation, it would not have been unusual. Since the extension of the tender offer period provided an enhanced market check and the amendments to the Lockup

vided certainty that the total expenses of cancellation would not exceed a certain amount, the settlement provided some, albeit speculative, value to Vitalink shareholders and did not convey only illusory benefits.

The Objectors argue that the value of the settlement is minimal in comparison with the claims asserted and the claims that could be asserted. As far as the claims that could be asserted, there is no indication of their merit. As far as the claims asserted, I have found them to be very weak. Thus, I hold that the benefits conferred by the settlement, even though they are speculative, are of sufficient value for the claims covered by the Settlement Agreement.

The Objectors also argue that the record is insufficiently developed to allow me to evaluate the proposed settlement in an informed manner. *See generally In re Republic American Corp. Litigation*, Del. Ch., C.A. No. 10112, Allen, C. (June 7, 1990), slip op. at 2 (where court declined to approve or reject a settlement proposal because the record contained insufficient information). I disagree with the Objectors. I have found the record to be sufficiently developed so as to afford a reasonable basis to respond to all of the asserted claims. Since I hold that there is an adequate basis upon which I am able to determine whether the Settlement Agreement was fair and since I have found the Settlement Agreement to be fair and reasonable, I approve the Settlement Agreement.

V. PLAINTIFF'S ATTORNEYS' FEES AND EXPENSES

Plaintiff requests me to award $275,000 for its attorneys' fees and expenses. In a class action, a court should award reasonable plaintiff's attorneys' fees and expenses where the attorneys achieve benefits for the class. *See Chrysler Corp. v. Dann*, Del. Supr., 223 A.2d 384, 386 (1966). In determining the issue of the amount of fee allowances in stockholder actions, a court should consider: (1) the benefits achieved in the action; (2) whether the fee is contin-

gent; (3) the efforts of counsel; (4) the difficulty of the litigation; and (5) the standing and ability of counsel involved. *See e.g., Sugarland Industries, Inc. v. Thomas*, Del. Supr., 420 A.2d 142, 142-50 (1980). Specifically, in evaluating fee requests where the settlement does not create a settlement fund, a court must apply a three-pronged test in evaluating the propriety of a fee request: (1) whether the claims were meritorious when plaintiff filed them; (2) whether the settlement creates a benefit to the corporatiton; and 93) whether plaintiff's litigation was causally related to the benefits. *See Allied Artists Pictures Corp.*, 413 A.2d at 878-80.

A claim is meritorious if there is some reasonable hope for its success when plaintiff filed it. *See Chrysler Corp.*, 223 A.2d at 384. The litigation is causally related to the benefit if the benefit arises after plaintiff filed the lawsuit and the defendant corporation is unable to demonstrate "that the lawsuit did not in any way cause their action." *Allied Artists Pictures Corp.*, 413 A.2d at 880.

Plaintiff argues and I agree that plaintiff's claims were meritorious when it filed them. Plaintiff reasonably believed that the claim had a good chance of success because Denend acted as negotiator for the transaction while also agreeing to work for Vitalink if NSC acquired it and because the Board had not contacted many other companies before agreeing to the transaction.

As far as the second factor, the benefits achieved from the litigation generally constitute the factor given the greatest weight in determining the fee to be awarded. *See In re Anderson Clayton Stockholders' Litig.*, Del. Ch., C.A. No. 8387, Allen, C. (Apr. 14, 1988), slip op. at 3. In this case, the settlement called for an extension of the tender offer for ten days. This extension provided an enhanced market check. Also, the settlement called for a limitation on the amount of the reimbursement agreement and the Lockup cancellation agreement. These limitations gave po-

tential third parties greater certainty as to how much a successful bid for Vitalink would cost. Further, the settlement called for the public announcement of these agreement. This public announcement further enhanced the market check afforded by the extension of the tender offer and the limitation of reimbursement agreement and Lockup termination agreement. Ultimately, the settlement provided speculative benefits to the class. Nonetheless, the class benefitted.

As to the third factor, there is a presumption of a causal relationship between the plaintiff's efforts and the benefits. *See In re Beatrice Companies, Inc. Litig., supra*, at 18. However, this presumption is not even necessary in this case because all agree that the benefits from the settlement were a direct result of the litigation.

Since plaintiff's attorneys have met all three prongs, I believe they are entitled to attorneys' fees. In evaluating the amount of the fee request, plaintiff relies on the contingent nature of the fee, the quality of legal services, the standing and ability of counsel and public policy considerations in arguing that I should award the entire $275,000.

Plaintiff's attorneys took this case on a contingent basis. In all fairness, the contingent nature of its fee agreement demands a higher fee for its work. *See Joseph v. Shell Oil Co.*, Del. Ch., C.A. No. 7450, Hartnett, V.C. (Apr. 19, 1985), slip op. at 14, *aff'd per curiam, Selfe v. Joseph*, Del. Supr., 501 A.2d 409 (1985).

The Objectors contend that plaintiff's attorneys failed to respond to some of its questions as to the proposed settlement. (Objectors' Brief at 39 fn. 15.) However, I believe that plaintiff's attorneys adequately responded to this claim at the settlement hearing. (*See* Squitieri at 75-76.) Thus, there is nothing that can lead me to believe that plaintiff's attorneys' services were anything but expeditious and effective.

As to plaintiff's attorneys' standing and ability, I find them to be in good standing and highly experienced in shareholder class action suits. "Lastly, I am mindful of the significant institutional role of class and derivative actions in the enforcement of the fiduciary duties assumed by corporate officers and directors." *In re Anderson Clayton Stockholders' Litig.*, *supra*, at 13.

After evaluating the contingent nature of the fee, the quality of legal services, the standing and ability of counsel, and the public policy considerations, I find $275,000 to be reasonable and award plaintiff's attorneys this amount.

VI. CONCLUSION

I find that the shareholders' due care and candor claims carry very little chance of success at trial. Further, I find that the Settlement Agreement conveyed some benefit to the shareholders. Thus, I hold that the Settlement Agreement is fair and approve it. Finally, I award $275,000 to plaintiff's attorneys for their fee and expenses.

An Order consistent with this opinion shall be prepared and submitted by counsel for the plaintiff and defendants.

APPENDIX D

Order on Rehearing Below

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 93-1268

C.L. GRIMES and G.W. HOLBROOK, on their own behalf and on behalf of all persons similarly situated,
Appellants

v.

VITALINK COMMUNICATIONS CORPORATION;
NETWORK SYSTEMS CORPORATION;
LESLIE G. DENEND; J. DANIEL McCRANIE;
CHARLES J. ABBE; HARRY T. REIN; LYLE D. ALTMAN

SUR PETITION FOR REHEARING

BEFORE: SLOVITER, *Chief Judge;* BECKER, STAPLETON, MANSMANN, GREENBERG, HUTCHINSON, SCIRICA, COWEN, NYGAARD, ALITO, ROTH, and LEWIS, *Circuit Judges*

The petition for rehearing filed by appellants having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of the circuit in regular active service not having voted for rehearing by the court in banc, the petition for rehearing is denied.

Judge Hutchinson would have granted rehearing in banc.

By the Court,

/s/ Robert E. Cowen
Circuit Judge

Dated: APR 6 1994

APPENDIX E
Judgment Below
UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 93-1268

C.L. GRIMES and G.W. HOLBROOK, on their own behalf and on behalf of all persons similarly situated,
Appellants

v.

VITALINK COMMUNICATIONS CORPORATION;
NETWORK SYSTEMS CORPORATION;
LESLIE G. DENEND; J. DANIEL McCRANIE;
CHARLES J. ABBE; HARRY T. REIN; LYLE D. ALTMAN

On Appeal from the United States District Court
for the Eastern District of Pennsylvania
(D.C. Civil No. 92-02722)

Present: Hutchinson, Cowen, and Nygaard, *Circuit Judges*

JUDGMENT

This cause came to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel on October 8, 1994.

On consideration whereof, it is now here ordered and adjudged by this Court that the judgment of the said District Court entered March 2, 1993, be, and the same is hereby affirmed. Each party to bear their own costs. All of the above in accordance with the opinion of this Court.

ATTEST:

/s/ P. Douglas Sisk
Clerk

Dated: March 9, 1994

Certified as a true copy and issued in lieu of a formal mandate on April 14, 1994

Teste: /s/ Bradford Baldus
Chief Deputy
Clerk, United States Court of Appeals for the Third Circuit

APPENDIX F
Judgment of the District Court
IN THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

CIVIL ACTION
No: 92-2722

C.L. GRIMES and G.W. HOLBROOK, on their own behalf and on behalf of all persons similarly situated,
Plaintiffs,

v.

VITALINK COMMUNICATIONS CORP., A Corporation, NETWORK SYSTEMS CORPORATION, a corporation; LESLIE DENEND, J. DANIEL McCRANIE, CHARLES J. ABBE, HARRY T. REIN, and LYLE ALTMAN,
Defendants.

ORDER

AND NOW, this 27th day of February 1993, upon consideration of Defendants' Motion for Summary Judgment, and Plaintiffs' response thereto, and Plaintiffs' Partial Motion for Summary Judgment, it is hereby ORDERED that Defendants' Motion for Summary Judgment is GRANTED and Plaintiffs' motion for Partial Summary Judgment is DENIED. Case dismissed.

BY THE COURT:

/s/ Robert S. Gawthrop, III
Robert S. Gawthrop, III

APPENDIX G

Order and Final Judgment of the Court of Chancery of Delaware Approving Settlement

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE IN AND FOR NEW CASTLE COUNTY

CONSOLIDATED C.A. No. 12085

IN RE VITALINK COMMUNICATIONS CORPORATION SHAREHOLDERS LITIGATION

ORDER AND FINAL JUDGMENT

AND NOW, this 15th day of November, 1991, the proposed settlement of this consolidated action (the "Consolidated Action") having come on to be heard on September 16, 1991, pursuant to the Order entered herein on July 18, 1991 (the "Order") and the Stipulation and Agreement of Compromise, Settlement and Release dated June 10, 1991 (the "Stipulation" or the "Settlement"); and the Court having determined that notice of said hearing was given in accordance with the Order to members of the class as certified by the Court in the Order (the "Class") and that said notice was the best notice practicable and constitutes due and sufficient notice; and the parties having appeared in person and/or by their attorneys of record; and the said person and/or attorneys for the respective parties having been heard in support of the Settlement of the Consolidated Action; and an opportunity to be heard having been given to all other persons desiring to be heard; and the entire matter of the Settlement having been considered by the Court;

IT IS ORDERED, ADJUDGED AND DECREED as follows:

1. The Notice of Pendency of Class Action, Class Action Determination, Proposed Settlement, Settlement Hearing and Right to Appear (the "Notice to the Class") has been

given to the members of the Class pursuant to and in the manner directed by this Court's Order of July 18, 1991; proof of mailing of said notice was filed with the Court by counsel for Vitalink Communications Corporation ("Vitalink") at or before the hearing; and full opportunity to be heard has been offered to all parties, Class members and persons in interest.

2. The Settlement is found to be fair, reasonable, adequate and in the best interests of the plaintiffs and other members of the Class and is hereby approved. The parties to the Stipulation are hereby authorized and directed to comply with and consummate the Settlement in accordance with its terms and provisions.

3. This Order and Final Judgment shall not constitute any evidence or admission by any party herein that any acts of wrongdoing have been committed by any of the parties to this Consolidated Action and shall not be deemed to create any inference that there is any liability therefor.

4. The Consolidated Action is hereby dismissed on the merits with prejudice as to all the defendants and the Defendants' Affiliates (as defined below) and against the plaintiffs and all other members of the Class without costs, except as provided in the Stipulation. All claims, rights, causes of action, suits, matters and issues, known or unknown, that arise now or hereafter out of, or that relate to, or that are, were or could have been asserted in connection with, Vitalink's and Network Systems Corporation's ("NSC") employment agreements, change of control agreements, stock arrangements, and similar arrangements with Vitalink's employees, the Stock Option Agreement, NSC's proposals to acquire Vitalink stock (including, without limitation, the Offer, the Merger Agreement and the Merger), the disclosures made in the Schedule 14D-9, the Offer and the Merger, or any matters, transactions or occurrences referred to in the complaints, or any other complaint in the Consolidated Action, or in the California

Actions (as defined in paragraph 6 of the Stipulation), or any public statements, announcements or other activities relating to any of the foregoing, or the Settlement (except for an action to enforce compliance with the terms of the Settlement or an action for appraisal rights under Sections 253(d) and 262 of the Delaware General Corporation Law) (the "Settled Claims"), by any member of the Class or by Vitalink, either directly, individually, derivatively, representatively or in any other capacity against any of the defendants in the Consolidated Action or the California Actions, their respective present or former officers, directors, stockholders, agents, employees, attorneys, representatives, advisors, investment bankers (including, without limitation, Kidder, Peabody & Co. and Salomon Brothers Inc. and their officers, directors, agents and employees), commercial bankers, accountants, insurers, trustees, parents, affiliates, subsidiaries (direct or indirect, including, without limitation, NSC Acquisition Corp.), directors and officers of such parents, affiliates and subsidiaries, general and limited partners, heirs, executors, personal representatives, estates, administrators, successors and assigns (collectively, the "Defendants' Affiliates"), are hereby compromised, settled, released and discharged.

5. The plaintiffs' attorneys are hereby awarded fees of $275,000, which fees and expenses the Court finds to be fair and reasonable and which Vitalink shall pay to the plaintiffs' attorneys in accordance with the terms of the Stipulation.

6. Without affecting the finality of this Order and Final Judgment in any way, the Court hereby reserves jurisdiction for the purpose of taking any action that may be appropriate to give effect to or enforce this Order and Final Judgment.

William B. Chandler, III
Vice Chancellor

APPENDIX H
Constitutional Provisions, Statutes, and Rules Involved

The Supremacy Clause
U.S. Constitution Art. VI § 2

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

The Federal Due Process Clause
U.S. Constitution Amendment 5

No person shall be . . . deprived of life, liberty, or property, without due process of law . . . .

The Due Process Clause of the Fourteenth Amendment
U.S. Constitution Amendment 14 § 1.

No state shall . . . deprive any person of life, liberty, or property, without due process of law . . . .

The Full Faith and Credit Act
28 U.S.C. § 1738

The Acts of the legislature of any State, Territory, or Possession of the United States, or copies thereof, shall be authenticated by affixing the seal of such State, Territory or Possession thereto.

The records and judicial proceedings of any court of any such State, Territory or Possession, or copies thereof, shall be proved or admitted in other courts within the United States and its Territories and Possessions by the attestation of the clerk and seal of the court annexed, if a seal exists, together with a certificate of a judge of the court that the said attestation is in proper form.

Such Acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken.

Rules of the Court of Chancery of Delaware, Rule 23

RULE 23. CLASS ACTIONS

(a) Requisites to Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of paragraph (a) are satisfied, and in addition:

(1) The prosecution of separate actions by or against individual members of the class would create a risk of:

(A) Inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or

(B) Adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or substantially impair or impede their ability to protect their interests; or

(2) The party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) The Court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matter pertinent to the findings include:

(A) The interest of members of the class in individually controlling the prosecution or defense of separate actions;

(B) The extent and nature of any litigation concerning the controversy already commenced by or against members of the class;

(C) The desirability or undesirability of concentrating the litigation of the claims in the particular forum;

(D) The difficulties likely to be encountered in the management of a class action.

(c) Determination by Order Whether Class Action to Be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the Court shall determine by order whether it is to be so maintained. An order under this paragraph may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under paragraph (b)(3), the Court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that:

(A) The Court will exclude him from the class if he so requests by a specified date;

(B) The judgment, whether favorable or not, will include all members who do not request exclusion; and

(C) Any member who does not request exclusion may, if he desires, enter an appearance through his counsel.

(3) The judgment in an action maintained as a class action under paragraph (b)(1) or (b)(2), whether or not favorable to the class, shall include and describe those whom the Court finds to be members of the class. The judgment in an action maintained as a class action under paragraph (b)(3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in paragraph (c)(2) was directed, and who have not requested exclusion, and whom the Court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) Orders in Conduct of Actions. In the conduct of actions to which this rule applies, the Court may make appropriate orders: (1) Determining the course of proceedings or prescribing measures to prevent undue repetition or complication in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the Court directs to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify whether they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate therefrom allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the Court, and notice by mail, publication or otherwise of the proposed dismissal or compromise shall be given to all members of the class in such manner as the Court directs; except that if the dismissal is to be without prejudice to the class or with prejudice to the plaintiff only, then such dismissal shall be ordered without notice thereof if there is a showing that no compensation in any form has passed directly or indirectly from any of the defendants to the plaintiff or plaintiff's attorney and that no promise to give any such compensation has been made.

APPENDIX I

The Delaware Complaint

IN THE COURT OF CHANCERY OF THE STATE OF DELAWARE IN AND FOR NEW CASTLE COUNTY

C.A. No. 12085

JOHN P. McCARTHY Profit Sharing Plan,

Plaintiff,

-against-

VITALINK COMMUNICATIONS CORPORATION, NETWORK SYSTEMS CORPORATIONS and LESLIE DENEND,

Defendants.

CLASS ACTION COMPLAINT

Plaintiff, by his attorneys, alleges upon information and belief, except as to paragraph 1 which plaintiff alleges upon knowledge, as follows:

1. Plaintiff is presently a stockholder of Vitalink Communications Corporation and has been at all relevant times hereto.

2. Defendant Vitalink Communications Corporation ("Vitalink") is a corporation duly organized and existing under the laws of the State of Delaware with its principal offices located at 6607 Kaiser Drive, Fremont, California. The Company mainly designs, makes, markets and supports data communications products known as wide area bridges. As of September 30, 1990 the Company had 13.4 million shares outstanding held by 588 stockholders of record.

3. Defendant Leslie Denend is, and at all times relevant hereto has been, Chief Executive Officer, President and Director of the board of directors.

4. By reason of his position with Vitalink as Chief Executive Officer, President and Director of the board of directors, Denend has a fiduciary relationship and responsibility to plaintiff and the other common public stockholders of Vitalink and owes to plaintiff and the other class members the highest obligations of good faith and fair dealing.

5. Defendant Network Systems Corporation ("Network") is a corporation duly organized and existing under the laws of the State of Delaware with offices in Minneapolis, Minnesota. As more specifically described below, on May 7, 1991, Network and Vitalink announced an agreement to consolidate with Vitalink shareholders receiving $10.50 per share.

CLASS ACTION ALLEGATIONS

6. Plaintiff brings this action on his own behalf and as a class action, pursuant to Rule 23 of the Rules of the Court of Chancery, on behalf of all common stockholders of Vitalink, or their successors in interest, who are or will be threatened with the deprivation of their equity interest in Vitalink by reason of the proposed elimination of the public shareholders of Vitalink by Network or who have been otherwise damaged by the acts hereinafter described (the "Class"). Excluded from the class are defendants herein and any person, firm, trust, corporation, or other entity related to or affiliated with any of defendants.

7. This action is properly maintainable as a class action because:

(a) The class is so numerous that joinder of all members is impracticable. There are more than 588 stockholders of record who are located throughout the United States;

(b) There are questions of law and fact which are common to the class and which predominate over questions affecting any individual class members;

(c) Plaintiff is committed to prosecuting this action and has retained competent counsel experienced in litigation of this nature. The claims of plaintiff are typical of the claims of the other members of the class and plaintiff has the same interests as the other members of the class. Accordingly, plaintiff is an adequate representative of the class and will fairly and adequately protect the interests of the class; and

(d) Plaintiff anticipates that there will be no difficulty in the management of this litigation.

8. For the reasons stated herein, a class action is superior to other available methods for the fair and efficient adjudication of this controversy and the requirements of Rule 23 of the Chancery Court Rules are satisfied.

CLAIM FOR RELIEF

9. Defendant Denend, aided and abetted by Network, has been engaged in a wrongful effort to entrench himself and other members of Vitalink's senior management, whose identities are presently unknown to plaintiff, and to prevent any acquisition of the Company except on terms that would further the personal interests of members of the management.

10. On May 7, 1991 it was announced that Network agreed to acquire Vitalink for $10.50 per share or about $146 million. Under the agreement, Network said it will begin a tender offer to acquire Vitalink's shares. The offer is contingent on at least one-half of Vitalink's shares being tendered and on Network signing employment agreements with certain, unnamed Vitalink employees.

11. Network also acquired an option from Vitalink to purchase, under certain circumstances, up to about 2.8 million shares of Vitalink's common stock at $10.50 per share, representing slightly less than 20% of Vitalink's outstanding common shares (the "Lockup Option").

12. Denend and the other members of Vitalink's senior management who will stay on as Network employees have significant responsibility for negotiating the terms of the transaction on behalf of Vitalink's shareholders. However, as future employees of the potential acquiror, their loyalties are divided because Network desires to pay the lowest possible price for Vitalink. Thus, the proposed transaction is not the result of arm's length negotiations an is not based upon any independent evaluation of the current value of Vitalink's common stock, assets or business. In further breach of their fiduciary obligations, Denend and the other members of Vitalink's senior management have thus far failed to announce any active auction or open bidding procedures best calculated to maximize shareholder value in selling the Company, and, indeed, have agreed to the Lockup Option which will only serve to inhibit the maximization of shareholder value.

13. Since the Lockup Option will foreclose or inhibit a reliable market check of the fairness of the transactions, Vitalink's stockholders will have no effective option other than to accept the unfair terms proposed by Network.

14. By virtue of the acts and conduct alleged herein, defendants are carrying out a preconceived plan to eliminate the public common stockholders of Vitalink in order to appropriate for Network, at an unfair price, the benefits of the ownership of the Company, including its potential and continuing growth and value. As a result of the proposed transaction, Vitalink's stockholders will be wrongfully deprived of their investment in Vitalink and all of its present and continuing profitability and growth and will receive, in return for their investment, grossly inadequate consideration. Pursuant to this plan, Vitalink's management will remain in their prestigious positions with the Company and will continue to receive the lucrative compensation which the Company has provided to them so far.

15. Defendants' knowledge and economic power and that of the investing public is unequal because Vitalink's management controls the business and corporate affairs of Vitalink and is in possession of material non-public information concerning the Company's assets, businesses and future prospects. This discrepancy makes it grossly and inherently unfair for Network to obtain ownership of Vitalink at the unfair and grossly inadequate price offered herein.

16. Vitalink, which has a strong distribution system, also has $100 million in cash or over $7 per share, while, according to at least one analyst, Network has aging management with no apparent successors securing its future.

17. Network had net income of $2 million, or $.07 per share, in the first quarter of 1991 on revenues of $33.6 million. Vitalink had net income of $4.5 million or $.31 per share for the six months ended March 31, 1991 on revenues of $26.1 million.

18. By virtue of the acts and conduct alleged herein, Denend and other members of Vitalink's senior management who influence the actions of the Company, aided and abetted by Network, have carried out a preconceived plan and scheme to place their own personal interests ahead of the interests of Vitalink's public stockholders and thereby entrench themselves in their offices and positions within the Company. The defendants have breached and/or aided and abetted the breach of fiduciary duties owed to plaintiff and the Class in that they have not and are not exercising independent business judgment and have acted and are acting to the detriment of Vitalink's public stockholders for their own personal benefit.

19. In announcing that an agreement had been reached with Network, Denend and those acting in concern with him, did not, as their fiduciary obligations required them to do, state that they had or would:

A) undertake an appropriate evaluation of Vitalink's worth as a merger/acquisition candidate;

B) take all appropriate steps to enhance Vitalink's value and attractiveness as a merger/acquisition candidate;

C) take all appropriate steps to effectively expose Vitalink to the marketplace in an effort to create an active auction for Vitalink;

D) act independently so that the interests of Vitalink's public stockholders would be protected; and

E) adequately ensure that no conflicts of interests existed between defendants' own interests and their fiduciary obligation to maximize stockholder value or, if such conflicts existed, to ensure that all conflicts would be resolved in the best interests of Vitalink's public stockholders.

20. Defendant Denend violated his fiduciary duties to Vitalink stockholders by agreeing to the sale of the Company to the offeror most likely to assure members of management's continued positions with Vitalink, rather than seeking the highest possible offer for Vitalink stockholders.

21. As a result of the actions of defendants, plaintiff and the other members of the class have been and will be damaged in that they have not and will not receive their proportionate share of the value of the Company's assets and business, have been and will be prevented from obtaining a fair price for their common stock, and have been and will be effectively disenfranchised.

22. Network has aided and abetted and induced the breaches of fiduciary duty by defendant Denend by offering incentives to members of management, whose identities are presently unknown to plaintiff, either in the form of continued employment or monetary compensation and perquisites, in exchange for their approval of the offer.

23. Unless enjoined by this Court, defendant Denend and the other unidentified members of Vitalink's senior management will continue to breach their fiduciary duties owed to plaintiff and the other members of the class, aided and abetted by Network, and will succeed in their plan to enrich themselves by virtue of the unfair dealing complained of and by excluding the class from its fair proportionate share of Vitalink's valuable assets and businesses, all to the irreparable harm of the class.

24. Plaintiff and their other members of the class have no adequate remedy at law.

WHEREFORE, plaintiff prays for judgment and relief as follows:

(1) ordering that this action may be maintained as a class action and certifying plaintiff as a class representative;

(2) declaring that defendants and each of them have committed or aided and abetted a gross abuse of trust and have breached their fiduciary and other duties to plaintiff and the other members of the class;

(3) preliminary and permanently enjoining defendants and their counsel, agents, employees and all persons acting under, in concert with, or for them, from proceeding with, consummating or closing the proposed transaction which will irreparably harm plaintiff and the class;

(4) in the event the proposal is consummated, rescinding it and setting it aside, or awarding rescissory damages if it cannot be set aside;

(5) awarding compensatory damages against defendants individually and severally in an amount to be determined upon the proof submitted to this Court;

(6) awarding costs and disbursements, including plaintiff's counsel and experts' fees; and

(7) granting such other and further relief as to the Court may seem just and proper.

Dated: May 9, 1991

MORRIS, ROSENTHAL, MONHAIT & GROSS, P.A.

By: /s/ J.A. ROSENTHAL

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APPENDIX J

The Complaint in the Instant Case

IN THE UNITED STATES DISTRICT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Civil Action
No. 92-CV-2722

JURY TRIAL DEMANDED

C.L. GRIMES and G.W. HOLBROOK, on their own behalf and on behalf of all persons similarly situated,

Plaintiffs,

v.

VITALINK COMMUNICATIONS CORPORATION, a Corporation; NETWORK SYSTEMS CORPORATION, a Corporation; LESLIE G. DENEND. J. DANIEL McCRANIE, CHARLES J. ABBE, HARRY T. REIN, and LYLE D. ALTMAN,

Defendants.

COMPLAINT

Nature of Action

1. This is an action to redress injury caused to the named plaintiffs and the other members of the plaintiff classes by defendants' violations of the federal securities laws and rules of the Securities Exchange Commission thereunder.

2. In brief, and subject to the more detailed narrative of events set forth hereinbelow, defendants induced the stockholders of defendant Vitalink Communications Corporation ("Vitalink") to sell their shares to defendant Network Systems Corporation ("NSC") at $10.50 per share, a price substantially less than the true value thereof. (The transaction was effectuated through a multi-step process

which is described in more detail hereinbelow, but the foregoing sentence describes the net effect of the transaction.) In connection with such purchase and sale of stock, defendants made statements of fact, and omissions to state facts, which were unlawful under SEC Rule 10b-5 and § 14(e) of the Securities Exchange Act of 1934. The holders of at least 85% of Vitalink stock, including plaintiff Holbrook, sold their shares to NSC in reliance on such statements and omissions. The tendering stockholders were thus injured in at least the amount of the difference between the true value of their shares and the price paid by NSC. The non-tendering stockholders, including plaintiff Grimes, were or will be thus injured in at least the amount of (a) the difference between the true value of their shares and the price obtained in the appraisal proceeding, plus (b) the cost and expense of the appraisal proceeding. Both categories of injury were proximately caused by the action of the tendering stockholders in selling their stock in reliance on the misstatements and omissions of the defendants.

3. In light of the requirements of Rule 11, plaintiffs wish to make the Court aware at the outset that there exists a "Stipulation and Agreement of Compromise, Settlement and Release" in connection with certain state court actions which defendants may contend bars this action. Plaintiffs do not believe that the said instrument is a valid bar to this action and will so contend if it is raised as a defense.

Jurisdiction of This Court

4. This Court has jurisdiction of this action under § 27 of the Securities Exchange Act of 1934, 15 U.S.C. § 78aa, in that it is based upon a violation of the said Act and rules of the Securities Exchange Commission thereunder, and more particularly upon violations of §§ 10(b) and 14(e) of the said Act, 15 U.S.C. §§ 78j and 78n(e), and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5. This Court also has jurisdiction of this action under 28 U.S.C. § 1331, in that

this is an action arising under the laws of the United States, to-wit, the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a *et seq.*

The Parties

5. Defendant Vitalink is a Delaware corporation with its principal place of business in California. As of the time of the acts herein complained of it had approximately 14,196,689 shares of common stock issued and outstanding. Such shares constituted "securities" within the meaning of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j, and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, and holders thereof constituted "security holders" within the meaning of § 14(e) of the said Act, 15 U.S.C. § 78n(e). References herein to "stock," "shares," and "stockholders" of Vitalink refer to such common stock and the holders thereof.

6. Defendant NSC is a Delaware corporation with its principal place of business in Minnesota.

7. Vitalink is, and since July 1, 1991 has been, a wholly-owned subsidiary of NSC. Prior to that time, Vitalink was a separate, publicly-held corporation whose stock was traded over the counter and quoted through the NASDAQ quotation system.

8. Defendants Denend, McCranie, Abbe, and Rein (hereinafter sometimes called "the individual Vitalink defendants") were all the members of the board of directors of Vitalink when the acts herein complained of took place. Defendant Altman was a director and chairman of the board of directors of NSC when the acts herein complained of took place.

9. The defendants and each of them combined and conspired together to commit the acts herein complained of, and each of them aided and abetted the others in the commission of the same; they and each of them acted

knowingly and with full awareness of the nature and probable consequences of their actions, and not through mere negligence or inadvertence; and they and each of them are jointly and severally liable to the plaintiffs.

10. Plaintiffs were stockholders in Vitalink at all material times. Plaintiff Grimes is a domiciliary and resident of this District and owned Two Hundred Thousand (200,000) shares of Vitalink. He did not tender or sell them, and was forced to participate in an appraisal proceeding and to give up his shares at the price set in such proceeding. Plaintiff Holbrook is a domiciliary and resident of Connecticut and owned Five Thousand (5000) shares of Vitalink. He tendered and sold them in reliance on the statements and omissions herein complained of.

Facts Showing That Plaintiffs Are Entitled to Relief

11. In or about May 1991, the individual Vitalink defendants reached an understanding with the management of NSC, including defendant Altman, under which, *inter alia*, NSC would acquire all the stock of Vitalink. This was to be accomplished by a multi-step process as follows:

(a) NSC would form a wholly-owned subsidiary, NSC Acquisition Corp. (hereinafter sometimes called "Acquisition").

(b) Acquisition would issue a tender offer, offering to buy shares of Vitalink at $10.50 per share subject to various conditions, including tender of at least a majority of outstanding shares (plus certain shares issuable on the exercise of stock options).

(c) After becoming the controlling stockholder of Vitalink, Acquisition would be merged into Vitalink, and Vitalink would continue as a wholly-owned subsidiary of NSC.

(d) Vitalink stockholders who did not tender their shares, and who in connection with the merger exercised the ap-

praisal rights of dissenting stockholders under the Delaware Corporation Law, would receive $10.50 per share and could pursue their appraisal rights under Delaware law.

12. As of May 6, 1991, Vitalink, NSC, and Acquisition entered into an "Amended and Restated Agreement and Plan of Merger" (sometimes hereinafter referred to as "the Merger Agreement"), which set forth the transaction described in the immediately preceding paragraph, as well as other agreements, conditions, and undertakings.

13. Pursuant to the agreements aforesaid, under date of May 13, 1991, through a document entitled "Offer to Purchase for Cash All Outstanding Shares of Common Stock (Including the Associated Common Stock Purchase Rights) of Vitalink Communications Corporation at $10.50 Net Per Share by NSC Acquisition Corp. a wholly owned subsidiary of Network Systems Corporation" and related letter of transmittal (sometimes hereinafter referred to as "the Offer"), Acquisition issued a tender offer for common stock of Vitalink at $10.50 per share.

14. Likewise under date of May 13, 1991, and pursuant to the agreements aforesaid, defendant Denend, on behalf of Vitalink, himself, and the other individual Vitalink defendants, issued a letter directed "To the Stockholders of Vitalink Communications Corporation" (sometimes hereinafter called "the Denend Letter"), which stated, *inter alia*, that Vitalink's board of directors had unanimously approved the Offer and the merger of Vitalink and Acquisition; that the board had determined "that the terms of each of the Offer and the Merger are fair to, and in the best interests of, the stockholders of Vitalink"; and that the board "recommends that Vitalink's stockholders accept the Offer and tender their Shares pursuant to the Offer."

15. Attached to the Denend Letter was a copy of a "Schedule 14D-9," a document filed with the Securities

and Exchange Commission by Vitalink with respect to the tender offer. The Denend Letter further stated:

> "In arriving at its recommendation, the Board of Directors has given careful consideration to a number of factors as described in the enclosed Schedule 14D-9 filed with the Securities and Exchange Commission, including the opinion of Kidder, Peabody & Co., Incorporated, Vitalink's financial advisor, that, as of the date of its opinion, the consideration to be received by the stockholders pursuant to the Agreement of Merger in the Offer and the Merger is fair to the stockholders from a financial point of view."

16. The Offer and the Denend Letter and attached Schedule 14D-9 (hereinafter sometimes collectively referred to as "the Soliciting Papers") were transmitted, by use of the mails and of means and instrumentalities of interstate commerce, to the stockholders of Vitalink, including the named plaintiffs herein and including, in particular, plaintiff Grimes, a domiciliary and resident of this District. Such transmittal took place on or after May 13, 1992, and such papers were received by such stockholders at various times thereafter.

17. In at least the following respects (without limitation), the Soliciting Papers constituted a device, scheme, or artifice to defraud; made untrue statements of material fact, and omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and constituted an act, practise, or course of conduct which operated or would have operated as a fraud or deceit upon the stockholders of Vitalink, including the named plaintiffs herein; to-wit:

(a) While providing a "fairness" opinion from Kidder, Peabody & Co., Incorporated (hereinafter "Kidder"), a major New York investment banking firm, in support of the price of $10.50 per share, they failed to disclose that two

such analyses, performed by Kidder and another major New York investment banking firm had concluded that the fair value of a share fell within ranges extending to figures as high as $21.02 per share; disclosure of which facts was necessary in order to make their statements about "fairness" of the transaction not misleading.

(b) They failed to inform stockholders of the standards applied under Delaware law to the valuation of stock in an appraisal proceeding, disclosure of which was necessary in order to make their statements about "fairness" of the transaction not misleading.

(c) They failed to disclose that Vitalink's investment bankers had not been authorized to pursue other opportunities for sale of Vitalink's stock, and to disclose that there was not in existence at the time the board of directors made its decision to recommend acceptance of the tender offer any body of reliable evidence as to the true value of Vitalink; disclosure of which facts was necessary in order to make their statements about "fairness" of the transaction not misleading.

(d) They failed to disclose clearly and effectively that both Vitalink's management and its investment bankers regarded the financial projections prepared for Vitalink by its management, which were a basis for a portion of Kidder's "fairness" opinion, to be unreliable; disclosure of which fact was necessary in order to make their statements about "fairness" of the transaction not misleading.

(e) They failed to disclose clearly and effectively the extent to which NSC had offered inducements to both current and successive prior managements of Vitalink to encourage their support for the acquisition of Vitalink by NSC; disclosure of which fact would have enabled stockholders more effectively to evaluate management's recommendation, and was necessary in order to make the Soliciting Papers' statements that management recom-

mended acceptance of the price proposed by NSC not misleading.

18. In reliance on the Soliciting Papers, stockholders of Vitalink holding 12,859,477 shares, including plaintiff Holbrook, tendered their shares, and such shares were purchased by NSC at $10.50 per share. Such stockholders are sometimes referred to herein as Tendering Stockholders.

19. Stockholders of Vitalink holding approximately 1,337,212 shares, including plaintiff Grimes, did not tender their shares. Such stockholders are sometimes referred to hereinafter as Remaining Stockholders.

20. Subsequently Acquisition acquired an additional 661,222 shares issued to certain employees and former employees of Vitalink upon the exercise of stock options, raising the total of such shares held by Acquisition as of July 11, 1991, to 13,520,699 shares, or approximately 91% of the stock of the company.

21. Under § 253 of the General Corporation Law of Delaware, a corporation owning 90% or more of the stock of a subsidiary corporation can merge itself into the subsidiary without action by any other stockholder, forcing dissenting stockholders to demand and have instituted an appraisal proceeding under § 262 of the General Corporation Law of Delaware.

22. Pursuant to the Merger Agreement and acting under the aforesaid § 253 of the General Corporation Law of Delaware, Acquisition caused itself to be merged into Vitalink as of July 1, 1991. As a result, Acquisition ceased to exist and Vitalink became a wholly-owned subsidiary of NSC. Further pursuant to the Merger Agreement, shares of Vitalink held by the Remaining Stockholders were converted into the right to receive $10.50 per share.

23. Under § 262 of the General Corporation Law of Delaware, Vitalink was obliged, either before or within 10 days after the effective date of the merger, to notify Re-

maining Stockholders that those who did not wish to accept $10.50 per share for their Vitalink stock had the right to dissent from the merger and seek an appraisal of their stock in a proceeding in the courts of Delaware. Accordingly, under date of July 11, 1991, Vitalink transmitted to Remaining Stockholders, by use of the mails and of means and instrumentalities of interstate commerce, a document entitled "Notice of Merger of NSC Acquisition Corp. A Wholly Owned Subsidiary of Network Systems Corporation into Vitalink Communications Corporation" (hereinafter sometimes called "the Notice of Merger"), which advised Remaining Stockholders of their appraisal rights and procedures in connection therewith, and of certain other matters.

24. The Notice of Merger disclosed for the first time that two valuation analyses, performed by Kidder and another major New York investment banking firm, had concluded that the fair value of a share fell within ranges extending to figures as high as $21.02 per share, and offered lengthy justifications, attributed to Kidder, for why its analysis was "not particularly applicable" to the Merger Agreement.

25. The Notice of Merger set forth the text of §§ 253(d) and 262 of the Delaware General Corporation Law relating to rights of dissenting stockholders and purported to summarize one holding of the Delaware Supreme Court with respect to the standards applied under those statutes to the valuation of stock in an appraisal proceeding, but failed to inform stockholders fully of the standards applied in such proceedings; full disclosure of which was necessary in order to make not misleading its statements with respect to information which should be considered by Remaining Stockholders "in considering whether to accept the $10.50 per Share cash payment pursuant to the Merger or to seek an appraisal of his or her Shares."

26. Except as set forth in the two paragraphs immediately preceding, the Notice of Merger provided no information relating to the material omissions from the Soliciting Papers.

27. On information and belief, in reliance on the Soliciting Papers and the Notice of Merger, some Remaining Stockholders, the number and share ownership of whom is not now known to the named plaintiffs, accepted $10.50 per share pursuant to the conversion.

28. Certain Remaining Stockholders, including plaintiff Grimes, availed themselves of the right to dissent from the merger and seek an appraisal of their stock in a proceeding in the Chancery Court of Delaware. Such an appraisal proceeding is now pending in that Court. The price which will be received by such stockholders pursuant to such appraisal proceeding will not necessarily be as great as the value of such stock for purposes of assessing damages in this action; nor may the expenses of the appraisal proceeding be fully recoverable in that proceeding.

Class Action Allegations

29. Plaintiffs Holbrook and Grimes bring this action on their own behalf and on behalf of all persons similarly situated, to-wit, all persons who were holders of the common stock of Vitalink at any time between May 6, 1991, and July 1, 1991, and who (a) accepted $10.50 per share for their stock in reliance on the Soliciting Papers, either alone or together with the Notice of Merger, or (b) were injured by such acceptance by other stockholders. Such class is hereinafter sometimes referred to as Class A.

30. Plaintiff Holbrook also brings this action on his own behalf and on behalf of all persons similarly situated, to-wit, all persons who were holders of the common stock of Vitalink at any time between May 6, 1991, and July 1, 1991, and who accepted $10.50 per share for their stock in reliance on the Soliciting Papers, either alone or to-

gether with the Notice of Merger. Such class is hereinafter sometimes referred to as Class B.

31. Plaintiff Grimes brings this action on his own behalf and on behalf of all persons similarly situated, to-wit, all persons who were holders of the common stock of Vitalink at any time between May 6, 1991, and July 1, 1991, and who did not accept $10.50 per share for their stock. Such class is hereinafter sometimes referred to as Class C.

32. The members of Classes A, B, and C are so numerous that joinder of them is impractical. The claims of the members of each of the classes involve common questions of law and fact. Plaintiffs Grimes and Holbrook are members of Class A and have suffered injury by reason of the acts of defendants complained of herein, and their claims are typical of the claims of Class A. Plaintiff Holbrook is also a member of Class B, has suffered injury by reason of the acts of defendants complained of herein, and his claims are typical of the claims of Class B. Plaintiff Grimes is a member of Class C, has suffered injury by reason of the acts of defendants complained of herein, and his claims are typical of the claims of Class C. Both named plaintiffs will fairly and adequately protect the interests of the classes and have no adverse or conflicting interests.

33. Questions of law and fact common to the members of the classes predominate over any questions affecting only individual members. A class action is superior to any other method available for a fair and efficient adjudication of the controversy, since it would be impractical, uneconomical, and undesirable for each of the members of the classes who may have suffered injury to bring separate actions in different jurisdictions.

COUNT ONE

34. Plaintiffs adopt and reallege the allegations of paragraphs 1 through 33 hereof.

35. The acts and representations of defendants set forth hereinabove constitute violations of § 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j, and SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, in that by such acts and representations the defendants jointly, and each of them separately and severally, by the use of the mails and of means or instrumentalities of interstate commerce, knowingly employed devices, schemes, and artifices to defraud; knowingly made untrue statements of material fact, and omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; and knowingly engaged in acts, practises, and courses of conduct which operated or would have operated as a fraud or deceit upon the stockholders of Vitalink, including the named plaintiffs herein, in connection with the purchase and sale of a security, to-wit, the common stock of Vitalink.

36. The members of Class A, including plaintiffs Grimes and Holbrook, were proximately injured by the reliance of the members of Class B upon the acts and representations of defendants aforesaid, as set forth with respect to the members of Classes B and C hereinbelow.

37. The members of Class B, including plaintiff Holbrook, relied upon the acts and representations of defendants aforesaid to their injury, in that in reliance thereon they sold their stock in Vitalink for a price per share which plaintiffs presently believe to have been at least $5.50 per share less than the true value thereof.

38. The members of Class C, including plaintiff Grimes, though they did not themselves rely upon the acts and representations of defendants aforesaid, were proximately injured by the reliance of the members of Class B thereon, in that such reliance enabled Acquisition to acquire sufficient stock of Vitalink to force the members of Class C either to accept a price per share which plaintiffs presently believe to have been at least $5.50 per share less than

the true value thereof, or to incur the expense and burden of an appraisal proceeding which is likely to net for such plaintiffs an amount less than the true value of their shares.

COUNT TWO

39. Plaintiffs adopt and reallege the allegations of paragraphs 1 through 38 hereof.

40. The acts and representations of defendants set forth hereinabove constitute violations of § 14(e) of the Securities Exchange Act of 1934, 15 U.S.C. § 78n(e), in that by such acts and representations the defendants jointly, and each of them separately and severally, knowingly made untrue statements of material fact, and omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, and knowingly engaged in fraudulent, deceptive, and manipulative acts and practices, in connection with the tender offer described hereinabove, and in connection with the solicitation of security holders, to-wit, the stockholders of Vitalink, in favor of such offer.

41. The members of Class A, including plaintiffs Grimes and Holbrook, were proximately injured by the violations of law set forth in the immediately preceding paragraph, as set forth with respect to the members of Classes B and C hereinbelow.

42. The members of Class B, including plaintiff Holbrook, were proximately injured by the violations of law set forth in the immediately preceding paragraph, in that such violations induced them to sell their stock in Vitalink for a price per share which plaintiffs presently believe to have been at least $5.50 per share less than the true value thereof.

43. The members of Class C, including plaintiff Grimes, were proximately injured by the violations of law set forth

in the immediately preceding paragraph, in that such violations caused Acquisition to acquire sufficient stock of Vitalink to force the members of Class C either to accept a price per share which plaintiffs presently believe to have been at least $5.50 per share less than the true value thereof, or to incur the expense and burden of an appraisal proceeding which is likely to net for such plaintiffs an amount less than the true value of their shares.

WHEREFORE, THE PREMISES CONSIDERED, plaintiffs pray that this Court will declare this action to be a proper class action and plaintiffs to be the representatives of Classes A, B, and C respectively; and plaintiffs demand judgment against defendants and each of them, jointly and severally, for (a) damages in the amount of $78,081,789.00 or such greater amount as the proof shall show (less such amount as Class C plaintiffs may net as a result of Delaware appraisal proceedings); (b) interest as allowed by law; and (c) their costs of suit, including but not limited to the fees of experts and reasonable attorneys' fees.

AND PLAINTIFFS PRAY for such other, further, or different relief as they may be entitled to in the premises.

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May 11, 1992

APPENDIX K

TABLE 1

Comparison of Complaint in Delaware Case and Instant Case

Key Allegations in the Delaware Complaint	Key Allegations in the Complaint in the Instant Case
9. Defendant Denend, aided and abetted by Network, has been engaged in a wrongful effort to entrench himself and other members of Vitalink's senior management . . . and to prevent any acquisition of the Company except on terms that would further the personal interests of members of the management.	9. The defendants and each of them combined and conspired together to commit the acts herein complained of, and each of them aided and abetted the others in the commission of the same; they and each of them acted knowingly and with full awareness of the nature and probable consequences of their actions, and not through mere negligence or inadvertence; and they and each of them are jointly and severally liable to the plaintiffs.
12. Denend and the other members of Vitalink's senior management who will stay on as Network employees have significant responsibility for negotiating the transaction on behalf of Vitalink's shareholders. However, as future employees of the potential acquiror, their loyalties are divided . . . . Thus, the proposed transaction is not the result of arms length negotiation . . . . In further breach of their fiduciary obligations, Denend and	17. In at least the following respects (without limitation), the Soliciting Papers constituted a device, scheme, or artifice to defraud; made untrue statements of material fact, and omitted to state material facts necessary in order to make the statements made, in the light of the circumstances under which they were

other members of Vitalink's senior management have thus far failed to announce any active auction . . . .

14. By virtue of the acts and conduct alleged herein, defendants are carrying out a preconceived plan to eliminate the public common stockholders of Vitalink in order to appropriate for Network, at an unfair price, the benefits of the ownership of the Company . . . . Pursuant to this plan, Vitalink's management will remain in their prestigious positions with the Company and will continue to receive . . . lucrative compensation . . . .

18. By virtue of the acts and conduct alleged herein, Denend and other senior members of Vitalink's senior management . . . have carried out a preconceived plan and scheme to place their own personal interests ahead of the interests of Vitalink's public stockholders . . . and thereby entrench themselves . . . . The defendants have breached and/or aided and abetted the breach of fiduciary

made, not misleading; and constituted an act, practise, or course of conduct which operated or would have operated as a fraud or deceit upon the stockholders of Vitalink, including the named plaintiffs herein; to-wit:

(a) While providing a "fairness" opinion from Kidder, Peabody & Co., Incorporated (hereinafter "Kidder"), a major New York investment banking firm, in support of the price of $10.50 per share, they failed to disclose that two such analyses, performed by Kidder and another major New York investment banking firm, had concluded that the fair value of a share fell within ranges extending to figures as high as $21.02 per share; disclosure of which facts was necessary in order to make their statements about "fairness" of the transaction not misleading.

(b) They failed to inform stockholders of the standards applied under Delaware law to the valuation of stock in an appraisal proceeding, disclosure of which was

duties . . . in that they have not and are not exercising independent business judgment and have acted and are acting to the detriment of Vitalink's public stockholders for their own personal benefit.

19. . . . Denend and those acting in concert with him, did not, as their fiduciary obligations required them to do, state that they had or would . . . undertake an appropriate evaluation of Vitalink's worth . . . take all appropriate steps to enhance Vitalink's value . . . take all appropriate steps to effectively expose Vitalink to the marketplace . . . act independently . . . adequately ensure that no conflicts of interest existed . . . .

20. Defendant Denend violated his fiduciary duties to Vitalink stockholders by agreeing to the sale of the Company to the offeror most likely to assure members of management's continued positions with Vitalink . . . .

necessary in order to make their statements about "fairness" of the transaction not misleading.

(c) They failed to disclose that Vitalink's investment bankers had not been authorized to pursue other opportunities for sale of Vitalink's stock, and to disclose that there was not in existence at the time the board of directors made its decision to recommend acceptance of the tender offer any body of reliable evidence as to the true value of Vitalink; disclosure of which facts was necessary in order to make their statements about "fairness" of the transaction not misleading.

(d) They failed to disclose clearly and effectively that both Vitalink's management and its investment bankers regarded the financial projections prepared for Vitalink by its management, which were a basis for a portion of Kidder's "fairness" opinion, to be unreliable; disclosure of which fact was necessary in order to make their statements

23. Unless enjoined by this Court, defendant Denend and the other . . . members of Vitalink's senior management will continue to breach their fiduciary duties . . . and will succeed in their plan to enrich themselves . . . .

about "fairness" of the transaction not misleading.

(e) They failed to disclose clearly and effectively the extent to which NSC had offered inducements to both current and successive prior managements of Vitalink to encourage their support for the acquisition of Vitalink by NSC; disclosure of which fact would have enabled stockholders more effectively to evaluate management's recommendation, and was necessary in order to make the Soliciting Papers' statements that management recommended acceptance of the price proposed by NSC not misleading.

18. In reliance on the Soliciting Papers, stockholders of Vitalink holding 12,859,477 shares, including plaintiff Holbrook, tendered their shares, and such shares were purchased by NSC at $10.50 per share. Such stockholders are sometimes referred to herein as Tendering Stockholders.

36. The members of Class A, including plaintiffs Grimes and Holbrook, were proximately injured by the reliance of the members of Class B upon the acts and representations of defendants aforesaid, as set forth with respect to the members of Classes B and C hereinbelow.

37. The members of Class B, including plaintiff Holbrook, relied upon the acts and representations of defendants aforesaid to their injury, in that in reliance thereon they sold their stock in Vitalink for a price per share which plaintiffs presently believe to have been at least $5.50 per share less than the true value thereof.

38. The members of Class C, including plaintiff Grimes, though they did not themselves rely upon the acts and representations of defendants aforesaid, were proximately injured by the reliance of the members of Class B thereon, in that such reliance enabled Acquisition to acquire sufficient stock of Vitalink to force the members of

Class C either to accept a price per share which plaintiffs presently believe to have been at least $5.50 per share less than the true value thereof, or to incur the expense and burden of an appraisal proceeding which is likely to net for such plaintiffs an amount less than the true value of their shares.

(2)

Supreme Court, U.S.
FILED
JUL 29 1994
OFFICE OF THE CLERK

No. 93-2098

In The

Supreme Court of the United States

October Term, 1994

C.L. GRIMES and G.W. HOLBROOK, on their own behalf and on behalf of all persons similarly situated,

Petitioners,

v.

VITALINK COMMUNICATIONS CORPORATION, a Corporation; NETWORK SYSTEMS CORPORATION, a Corporation; LESLIE G. DENEND, J. DANIEL MCCRANIE, CHARLES J. ABBE, HARRY T. REIN, and LYLE D. ALTMAN,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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Dated: July 29, 1994

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QUESTIONS PRESENTED

1. Are the Petitioners barred under the principles of *res judicata* from challenging in a subsequent action the authority of a state court to release claims within the exclusive jurisdiction of the federal courts where the state court gave Petitioners a full and fair opportunity to challenge that court's authority to issue such a release?

2. Does a state court have authority to approve a settlement of a class action that releases claims within the exclusive jurisdiction of the federal courts where such claims arose out of the same nucleus of operative facts that gave rise to the state claims?

3. Are the Petitioners barred under the doctrine of collateral estoppel from relitigating the adequacy of representation, the fairness of a settlement and the materiality of certain disclosures made in connection with a tender offer and merger after these issues were actually litigated and finally determined in a state court judgment?

LIST OF PARENT COMPANIES AND NON-WHOLLY OWNED SUBSIDIARIES

Respondent Network Systems Corporation has no parent company and no non-wholly owned subsidiaries.

The parent company of Respondent Vitalink Communications Corporation is Network Systems Corporation, which has no non-wholly owned subsidiaries.

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No. 93-2098

In The

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October Term, 1994

C.L. GRIMES and G.W. HOLBROOK, on their own behalf and on behalf of all persons similarly situated,

Petitioners,

v.

VITALINK COMMUNICATIONS CORPORATION, a Corporation; NETWORK SYSTEMS CORPORATION, a Corporation; LESLIE G. DENEND, J. DANIEL MCCRANIE, CHARLES J. ABBE, HARRY T. REIN, and LYLE D. ALTMAN,

Respondents.

On Petition For A Writ Of Certiorari
To The United States Court Of Appeals
For The Third Circuit

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

OPINIONS AND JUDGMENTS BELOW

This Petition arises out of an Order and Final Judgment of the Delaware Court of Chancery dated November 15, 1991 (the "Delaware Judgment") approving the settlement (the "Settlement") of a consolidated class action captioned *In re Vitalink Communications Corp. Shareholders Litig.*, Consolidated C.A. No. 12085 (Del. Ch.) (the "Delaware Action"). The Delaware Judgment and related 39-page Memorandum Opinion of the Delaware Court of Chancery are unreported but are reproduced at P91a[1] and P53a-87a, respectively. The Delaware Judgment was affirmed by the Supreme Court of Delaware on April 30, 1992 (R1a-2a). On October 5, 1992, the United States Supreme Court denied a petition for a writ of certiorari to the Supreme Court of Delaware (the "First Petition") filed by one of the Petitioners herein. *Grimes v. John P. McCarthy Profit Sharing Plan*, 113 S. Ct. 179 (1992).

Less than a month after the Delaware Supreme Court affirmed the judgment of the Court of Chancery, and before the First Petition was filed, the Petitioners filed an action under §§ 10(b) and 14(e) of the Securities Exchange Act of 1934. The United States District Court for the Eastern District of Pennsylvania granted the Respondents' motion for summary judgment and dismissed the case on February 27, 1993. (P90a) In its opinion, the district court held that the Delaware Judgment barred the federal securities law action on the grounds of release and collateral estoppel. (P42a-52a) On March 9, 1994, the United States Circuit Court of Appeals for the Third

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[1] References to the Petition are cited hereinafter as "P___"; references to Petitioners' appendix are cited as "P___a"; and references to the appendix attached hereto are cited as "R___a."

Circuit affirmed the district court order. (P88a-89a; P1a-41a)

JURISDICTION

The Supreme Court has jurisdiction over this case by virtue of 28 U.S.C. § 1254. This Court should not exercise jurisdiction under Supreme Court Rule 10 because the Petitioners fail to present any unsettled issues of federal law or any issues of federal law that are in conflict among the courts of appeals.

SUMMARY OF ARGUMENT

The Petitioners brought a federal securities law action in the United States District Court for the Eastern District of Pennsylvania challenging certain disclosures made in connection with a tender offer (the "Offer") for the common stock of Vitalink Communications Corporation ("Vitalink") and a subsequent merger (the "Merger") of Vitalink into Network Systems Corporation ("NSC"). These same transactions were the subject of an earlier class action in which the Delaware Court of Chancery, after approving the Settlement, entered a judgment over the objections of, among others, Petitioner Charles L. Grimes and Gadfly Foundation Inc., a foundation for which Grimes serves as Trustee.

In a 39-page opinion, the Court of Chancery rejected Petitioner Grimes' objections concerning the adequacy of representation of class counsel, the fairness of the Settlement, and the disclosures accompanying the Offer and Merger. The court entered an order releasing all claims arising out of the Offer, Merger and Settlement of the action. On appeal, the Delaware Supreme Court rejected Petitioner Grimes' contentions and affirmed the judgment

on the basis of the Chancery Court's "well-reasoned memorandum opinion. . . . " The United States Supreme Court thereafter denied certiorari after Petitioner Grimes filed his First Petition.

After the Delaware Supreme Court affirmed the Chancery Court's judgment, Petitioner Grimes changed lawyers, added Petitioner Holbrook and brought this action. In response to the Respondents' motion to dismiss, the Petitioners argued that the Delaware court did not have subject matter jurisdiction to release the Petitioners' federal claims asserted in the district court. They also reasserted claims attacking the adequacy of representation, the fairness of the Settlement and the disclosures made in connection with the Offer and Merger. All of these claims were released by the Delaware Judgment.

The Petitioners' challenges are barred by the full faith and credit statute. 28 U.S.C.A. § 1738. The statute bars collateral attacks on decisions of a state court once a party has had an opportunity to have his day in court. Here, the Petitioners had ample opportunity to present evidence and air their views regarding the Release, the adequacy of representation, the fairness of the Settlement and the disclosures made in connection with the Offer and Merger. Petitioner Grimes litigated these issues and lost. Petitioner Holbrook chose not to participate in the Delaware action.

Even if the full faith and credit statute did not bar the Petitioners' subject matter jurisdictional argument, their position concerning Delaware's authority to issue the Delaware Judgment containing broad releases ignores applicable law. Federal courts consistently hold that a state court may, in approving a settlement of a class action, release claims within the exclusive jurisdiction of the federal courts if the federal claims arise out of the

same factual predicate as the underlying state law claims. *See, e.g., Nottingham Partners v. Trans-Lux Corp.*, 925 F.2d 29, 32-33 (1st Cir. 1991). The Petitioners offer a distorted analysis of the case law to seek a radical departure from this well-established precedent.

The Third Circuit properly affirmed the district court's grant of summary judgment which held that the Delaware Judgment barred the federal action on the grounds of release and collateral estoppel. This Court should deny this second Petition for a Writ of Certiorari (the "Second Petition").

STATEMENT OF THE CASE

1. The Parties.

Before the Merger, Vitalink and NSC were separate, publicly held corporations. (P109a, ¶¶ 5-7) Respondents Leslie G. Denend, J. Daniel McCranie, Charles J. Abbe and Harry T. Rein (the "Vitalink Respondents") were members of the Vitalink board of directors and, as a board, recommended to the Vitalink stockholders that the stockholders accept the Offer. (P109a, ¶ 8: P111a, ¶ 14) Respondent Lyle D. Altman was a director and chairman of the NSC board of directors. (P109a, ¶ 8) After the Merger, Vitalink became a wholly owned subsidiary of NSC. (P109a, ¶ 7)

The Petitioners are former Vitalink stockholders and members of a class certified in the Delaware action. (P110a, ¶ 10) Petitioner Grimes did not tender his shares into the Offer, dissented from the Merger, and sought

appraisal of his shares.[2] (P110a, ¶ 10) Petitioner Holbrook tendered his shares into the Offer. (P110a, ¶ 10)

2. Background.

On May 6, 1991, NSC and Vitalink entered into a merger agreement in which NSC, through a wholly owned subsidiary, agreed to acquire all the common shares of Vitalink in a two-step transaction (the "Merger Agreement"). (P111a, ¶¶ 12-13) The Offer and the Merger formed the two steps of the transaction. (P110a-111a, ¶ 11) NSC agreed to pay $10.50 per share in cash for the Vitalink stock in both the Offer and the Merger.

The NSC subsidiary commenced the Offer on May 13, 1991. (P111a, ¶ 13) On that same day, Denend sent a letter to the Vitalink stockholders recommending that they accept the Offer (the "Denend Letter"). (P111a, ¶ 14) The Denend Letter informed the Vitalink stockholders that the Vitalink board had (a) unanimously approved the Offer and the Merger, (b) determined that the terms of the Offer were fair and in the best interests of the stockholders, and (c) recommended that the Vitalink stockholders accept the Offer. (P111a, ¶ 14) Attached to the Denend Letter was a copy of a Schedule 14D-9 that Vitalink filed with the Securities and Exchange Commission. The Schedule 14D-9 provided a more detailed description of the terms of the Offer and the Merger, as well as certain background facts underlying the transaction. (P111a, ¶ 15)

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[2] The Delaware appraisal action currently is stayed by agreement of the parties pending disposition of this appeal.

3. Seven Stockholder Actions Are Filed.

Shortly after the announcement of the Merger Agreement, seven Vitalink stockholders filed suit. Four suits were filed in Delaware and three in California. (P3a) The plaintiffs in these actions alleged that the Vitalink Respondents had breached the fiduciary duties they owed to Vitalink's stockholders. Some plaintiffs also charged NSC with aiding and abetting the Vitalink Respondents in their alleged breaches. (P3a) During May 1991, the parties in the Delaware actions engaged in expedited discovery in connection with a motion by the Delaware plaintiffs to enjoin preliminarily the consummation of the Offer. (P3a)

4. The Settlement.

After discovery, the parties to the Delaware and California actions agreed to settle. They executed a Stipulation and Agreement of Compromise, Settlement and Release on June 13, 1991 (the "Settlement"). (P3a) The Settlement released "[a]ll claims, rights, causes of action [and] suits" arising out of the Offer, the Merger, the accompanying disclosures or any other related event (the "Release"). (*See* P92a) The Settlement and Release were in consideration of certain benefits conferred upon the class. (P3a-4a; P58a-59a)

The Offer, as extended, expired on June 20, 1991. NSC purchased approximately 90.7 percent of the outstanding shares of Vitalink common stock in the Offer and from certain employees and former employees who exercised stock options. (P59a) The Merger was consummated on July 1, 1991. (P59a)

5. Delaware Chancery Court Approves Settlement After Considering Petitioner Grimes' Objections.

On July 18, 1991, the Delaware Court of Chancery entered an order certifying a class under Court of Chancery Rule 23(b)(1) and (2).[3] (P5a) The class included Vitalink stockholders who held Vitalink common stock between May 6, 1991 and July 1, 1991, the effective date of the Merger.[4] (P5a) The Court of Chancery also scheduled a hearing on the proposed Settlement set for September 16, 1991. (P59a)

The Petitioners were well-informed about the Settlement. NSC issued a press release on June 3, 1991, announcing the Settlement which was reported by the wire services. (R3a-7a) On July 11, 1991, NSC mailed a notice of merger that also disclosed the Settlement. (P59a) On July 29, 1991, pursuant to an order of the Court of Chancery, Vitalink mailed a Notice of Pendency of Class Action, Class Action Determination, Proposed Settlement, Settlement Hearing and Right to Appear (the "Notice") to all record holders who held Vitalink stock between May 6, 1991, and July 1, 1991, informing them, among other things, that the Chancery Court had scheduled a settlement hearing on September 16, 1991, and that they had a right to object to the Settlement. (P59a)

On September 6, 1991, Petitioner Grimes, along with several other stockholders, entered an objection to the Settlement. (P5a) Before the Settlement hearing, Petitioner Grimes submitted a 45-page memorandum of law in support of his objections. At the hearing, Petitioner

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[3] This rule is virtually identical to Federal Rules of Civil Procedure 23(b)(1) and (2).

[4] The Petitioners brought this action on behalf of the same class. (P116a, ¶ 29)

Grimes appeared through counsel and presented oral argument. Petitioner Grimes attacked the fairness of the Settlement, claiming that it conferred "absolutely no benefits" but would "force upon the class a broad release that will forever bar it from asserting any claims against the named defendants. . . . " (R11a) Among the "strong claims" that Petitioner Grimes argued would be released by the Settlement for "illusory consideration" were claims that the Vitalink Respondents breached their duty of candor under Delaware law and violated the federal securities laws. (*See* R12a, R16a; P75a)

Petitioner Grimes' principal disclosure claims attacked Vitalink's Schedule 14D-9 under federal and state law for failing to provide details about the analysis performed by Vitalink's financial advisor, Kidder, Peabody & Co. Incorporated ("Kidder"), and about the methodology utilized by Vitalink in conducting a search for potential partners. Petitioner Grimes contended that the Vitalink Respondents violated their disclosure duties for the following reasons:

> "the Offer to Purchase and Schedule 14D-9 did not discuss or summarize Kidder's valuation analysis and its limitations nor did they contain a summary of the various valuation ranges that Kidder calculated";
>
> they failed "to inform [Vitalink] stockholders that they were not soliciting bids from third parties" and thus failed to canvass the market; and
>
> they caused a deletion of a sentence from a draft of a Kidder financial opinion which had stated that Kidder has " 'not been [requested] to, and did not solicit third party indications of interest in acquiring all or any part of the Company.' "

(*See generally* P75a-80a)

On November 8, 1991, six weeks after the settlement hearing, the Court of Chancery issued a comprehensive 39-page memorandum opinion that rejected Petitioner Grimes' arguments and approved the Settlement. (P53a-85a) This opinion is a model of careful judicial scrutiny. The court considered each of Petitioner Grimes' arguments in support of his contention that the Settlement offered no value to the class in return for the released claims. The court concluded that the claims being released were "very weak" and that the record was sufficiently developed to warrant approval of the Settlement as "fair and reasonable. . . . " (P82a) In particular, the court, relying on the standards enunciated in *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449 (1976), held that the purported nondisclosures were not material or misleading. (P77a-80a)

The Court of Chancery also evaluated the Delaware plaintiffs' application for attorneys' fees and expenses. (P82a-85a) The court found that the fee request was reasonable. The court considered the contingent nature of the fee, the quality of legal services, the standing and ability of counsel, as well as public policy considerations. (P85a) Overall, the court concluded that the services provided by class counsel were "expeditious and effective." (P84a) The court entered an Order and Final Judgment approving the Settlement, dismissing the claims with prejudice and releasing any and all further claims relating to or arising out of the Offer, the Merger, the disclosures accompanying them *and* the Settlement itself. (P91a-93a)

6. Petitioner Grimes' Appeals Are Rejected By The Delaware Supreme Court And The United States Supreme Court.

Shortly thereafter, Petitioner Grimes appealed the Delaware Judgment to the Delaware Supreme Court.

After briefing and oral argument, the Delaware Supreme Court issued an order affirming the judgment of the Court of Chancery on the basis of that court's "well-reasoned memorandum opinion. . . . " (R1a-2a)

Petitioner Grimes filed his First Petition with this Court claiming that the proceedings in the Delaware courts violated due process. Petitioner Grimes argued that these courts did not develop an adequate record from which to consider whether the absent class members were adequately represented. (P6a) The Court denied the First Petition on October 5, 1992. *Grimes v. John P. McCarthy Profit Sharing Plan*, 113 S. Ct. 179 (1992).

7. The Petitioners File Suit In District Court.

Less than a month after the Delaware Supreme Court affirmed the judgment of the Court of Chancery, and before Petitioner Grimes filed his First Petition, the Petitioners filed this action in the United States District Court for the Eastern District of Pennsylvania under Sections 10(b) and 14(e) of the Securities Exchange Act of 1934. 15 U.S.C. §§ 78j and 78n(e). Like the Petitioners' claims in the Delaware state action, their federal claims in the district court were based on the public disclosures surrounding the Offer and Merger, and they challenged many of the same disclosures that the Delaware court found to be not misleading. (P112a-114a, ¶ 17; P115a, ¶ 25)

8. The District Court Grants Summary Judgment In Favor Of The Respondents.

Vitalink, NSC and the individual Respondents moved to dismiss this action based on the Delaware Judgment. (P6a) The Petitioners asked the court below to treat the

Respondents' motion as one for summary judgment, submitted several documents of their own, and cross-moved for summary judgment. (P6a-7a) The district court held that the Petitioners were barred from maintaining their claims in this action by the Release and Delaware Judgment. (*See* P48a; P50a) The district court found that the Petitioners were members of a class who were bound by the Release issued in the Delaware Judgment which barred all claims, including claims under federal securities laws. (P48a) Second, and alternatively, the district court found that the issues raised by the federal securities action were barred by collateral estoppel, because the predicate facts that underlie the federal case, which primarily involve issues of nondisclosure, overlap with the facts underlying the state court proceeding. (P50a) The district court also examined the Petitioners' allegation that they were denied due process in the state court proceedings and concluded that this claim simply did "not jive with the record." (P51a) Accordingly, the district court granted summary judgment in favor of the Respondents. (P51a-52a)

9. The Third Circuit Affirms The District Court's Judgment.

As discussed in greater detail *infra*, the United States Court of Appeals for the Third Circuit affirmed the district court's judgment on March 9, 1994. The panel for the Third Circuit unanimously affirmed the district court's ruling that the Delaware Court of Chancery could enter an order releasing all claims, including federal securities claims. The Third Circuit also affirmed the district court's ruling that the Petitioners' action was barred by the collateral estoppel effect of the Delaware Judgment. (*See* 19a)

Circuit Judge Hutchinson concurred with the Third Circuit's holding that Petitioner Grimes was barred from maintaining this action, but dissented with respect to Petitioner Holbrook stating that Petitioner Holbrook was not bound by the Delaware Judgment because the Delaware courts lacked personal jurisdiction over him. (*See* P23a)

REASONS FOR DENYING THE WRIT

The Petitioners contend that this Court should approach their Petition "from the crucial viewpoint of the Delaware Chancery Court's *subject matter* jurisdiction" and not "from the irrelevant viewpoint of . . . *personal* jurisdiction" over the Petitioners. (P7) They argue that the question of a state court's ability to release claims within the exclusive jurisdiction of the federal courts "is far and away the most important aspect of the case." (P17) However, *res judicata* bars the Petitioners from raising this issue. In addition, even if they could raise it, well-established authority shows that the Delaware Court of Chancery had authority to approve a settlement releasing claims within the exclusive jurisdiction of the federal courts. No split of authority exists among the circuits concerning whether a state court can release federal claims in a settlement agreement.

Furthermore, the doctrine of collateral estoppel bars the Petitioners' arguments relating to the adequacy of representation, the fairness of the Settlement and the disclosures made in connection with the Offer and Merger. The Delaware courts provided the Petitioners with all well-recognized due process protections, carefully considered all contentions and properly found that the record was sufficiently developed to approve the

Settlement. The Petitioners' newly fashioned constitutional attack of Delaware's law on issue preclusion is belated, without merit and not worthy of this Court's consideration.

Finally, the Petitioners' concession that the issue of personal jurisdiction is "irrelevant" is fatal to their Petition. Even if the issue of personal jurisdiction were relevant, the record below establishes that Delaware had sufficient contacts with the Petitioners to exercise personal jurisdiction over them and to release the claims. The Petitioners fail to show any authority to rebut Delaware's assertion of personal jurisdiction or to discuss authority relied on by the district court and Third Circuit supporting the Delaware Court of Chancery's exercise of jurisdiction over the Petitioners.

A. THE DELAWARE COURT OF CHANCERY'S DECISION TO RELEASE THE FEDERAL SECURITIES CLAIMS IS ENTITLED TO FULL FAITH AND CREDIT UNDER THE DOCTRINE OF RES JUDICATA.

The Petitioners argue that the Court of Chancery had no power to approve a settlement releasing claims within the exclusive jurisdiction of the federal courts. This claim is barred by the full faith and credit due the Delaware Judgment. The " 'principles of *res judicata* apply to questions of jurisdiction as well as to other issues.' " *Underwriters Nat'l Assurance Co. v. North Carolina Life & Accident & Health Ins. Guar. Ass'n*, 455 U.S. 691, 706 (1982). Once a party has had an opportunity to present his view of the law in one action, a subsequent collateral attack on the jurisdiction of the first court is not permitted. *Id.* at 706 n.13. Such an attack would "merely retr[y] the issue[s] previously determined" and undermine "[t]he need for

finality [, that] applies with equal force to questions of jurisdiction." *Id.*

The Delaware court gave the Petitioners a full and fair opportunity to challenge that court's authority to release the class federal disclosure claims. Like the North Carolina Association in *Underwriters Nat'l*, they received notice of the Settlement which fully disclosed that the Settlement would release all claims arising out of the transaction. *Id.* at 707. Under *Underwriters Nat'l*, the Petitioners were "obliged to advance [their] argument" that the Delaware court "did not have the authority to settle" the federal claims when they were given the opportunity to do so. *Id.* at 710.

Petitioner Grimes argued, and the Court of Chancery considered, that the Settlement would release the class federal disclosure claims. (P75a) Yet, Petitioner Grimes did not challenge the Delaware courts' jurisdiction to grant the Release. Petitioner Holbrook chose to do nothing. "A party cannot escape the requirements of full faith and credit and res judicata by asserting its own failure to raise matters clearly within the scope of a prior proceeding." *Underwriters Nat'l*, 455 U.S. at 710. Moreover, if they had raised the issue, the Delaware Chancery Court would have been required to follow the Delaware Supreme Court's precedent in *Nottingham Partners v. Dana*, 564 A.2d 1089, 1104 (Del. 1989), holding that Delaware state courts possess subject matter jurisdiction to dismiss federal claims as part of a settlement agreement. The Petitioners cannot now raise this subject matter jurisdiction argument in the federal courts.

B. FEDERAL COURTS HAVE UNIFORMLY RECOGNIZED THE POWER OF STATE COURTS TO RELEASE CLAIMS WITHIN THE EXCLUSIVE JURISDICTION OF THE FEDERAL COURTS.

Even if the Petitioners could challenge the Delaware Chancery Court's jurisdiction to release their claims, the challenge would fail because state courts have the power to release federal claims. Indeed, the Third Circuit below held "that as a matter of federal law a state court has the power to enter a settlement negotiated by the parties as a judgment which releases exclusive federal claims that the state court could not itself entertain." (P21a) In so holding, the Third Circuit found that "several other federal courts . . . have recognized the broad power of state courts to approve and enforce settlements which reflect the parties' intent to release all claims arising from a transaction regardless of whether the class action court has jurisdictional competency to hear those claims." *Id.*; *see generally Nottingham Partners*, 925 F.2d at 34; *Abramson v. Pennwood Inv. Corp.*, 392 F.2d 759, 762 (2d Cir. 1968); *Sandler Assocs., L.P. v. BellSouth Corp.*, 818 F. Supp. 695, 704-05 (D. Del. 1993), *aff'd mem.*, No. 91-1447, 1994 U.S. App. LEXIS 12569 (3d Cir. Apr. 12, 1994); *Lowenschuss v. Resorts Int'l, Inc.*, No. 89-1071, 1989 U.S. Dist. LEXIS 7407, at *20 n.15 (E.D. Pa. June 29, 1989), *aff'd mem.*, 947 F.2d 936 (3d Cir. 1991).

In facts remarkably similar to the facts of this case, the First Circuit, in *Nottingham*, found that:

> as a general matter, federal courts recognize that a court can approve a settlement agreement embodying terms which the court would ordinarily have no power to promulgate. . . . Hence, as a matter of federal law, a state court can approve and enforce a settlement which requires

> a party to release claims actually brought, or potentially "bringable," in federal court under "exclusive jurisdiction" federal statutes even though the state court could not adjudicate claims arising under such statutes. *See TBK Partners[, Ltd. v. Western Union Corp.*], 675 F.2d [456,] 460 [(2d Cir. 1982)]; *Abramson v. Pennwood Inv. Corp.*, 392 F.2d 759, 762 (2d Cir. 1968); *Seagoing [Uniform Corp. v. Texaco, Inc.]*, 705 F. Supp. [918,] 923 [(S.D.N.Y. 1989)]. And where, as here, the federal law claims to be released stemmed from the same nucleus of operative fact as the state law claims, the release could legitimately be used as a defense to the former in a federal venue.

925 F.2d at 34.

Other federal circuit courts have recognized, like the First and Third Circuit, that a court may approve a release of claims which are outside the jurisdiction of the issuing court. For instance, the Second Circuit has ruled several times that a court may approve such a settlement. *See TBK Partners, Ltd. v. Western Union Corp.*, 675 F.2d 456, 460 (2d Cir. 1982) (collecting cases). Similarly, the Ninth Circuit, explaining that the breadth of settlement negotiations is not necessarily confined by the pleadings, held that a district court need not have subject matter jurisdiction over claims to approve their release. *Class Plaintiffs v. City of Seattle*, 955 F.2d 1268, 1287-89 (9th Cir.), *cert. denied*, 113 S. Ct. 408 (1992). The Fifth Circuit endorsed the same principle by stating "[t]he weight of authority establishes that in such a case, a court may release not only those claims alleged in the complaint and before the court, but also claims which 'could have been alleged by reason of or in connection with any matter or facts set forth or referred to in' the complaint." *In re Corrugated Container Antitrust Litig.*, 643 F.2d 195, 221 (5th Cir.), *aff'd*,

659 F.2d 1322 (1981), *quoting Patterson v. Stovall*, 528 F.2d 108, 110 n.2 (7th Cir. 1976).

Federal district court decisions are also in agreement. *See, e.g., Lowenschuss v. Resorts Int'l*, No. 89-1071, 1989 U.S. Dist. LEXIS 7407 (E.D. June 29, 1989); *Sandler*, 818 F. Supp. at 695. Indeed, in a recent case that is strikingly similar to this case, the United States District Court for the District of Delaware stated that federal law on this question is uniform:

> When called upon to resolve this question [the release of exclusively federal claims by a state court], *federal courts have uniformly dismissed claims*, including claims committed to their exclusive jurisdiction, that have been released in settlement of class actions brought in state courts.

Sandler, 818 F. Supp. at 704 (emphasis added). This decision was affirmed without opinion by the Third Circuit.[5] *See Sandler*, 1994 U.S. App. LEXIS 12569.

Federal recognition of state court releases and state recognition of federal releases both are based on the principles of comity and federalism underlying the full faith and credit clause. Comity serves important policy interests because it permits state courts to achieve comprehensive settlements that "prevent relitigation of settled questions at the core of a class action. . . . " *TBK Partners*, 675 F.2d at 460. As explained in *Sandler*, comity between state and federal courts is "crucial":

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[5] Commentators also agree. *See, e.g.*, 18 Charles A. Wright et al., *Federal Practice and Procedure* § 4470 at 688 (1981) ("[a]part from claim preclusion as such, settlement of state court litigation has been held to defeat a subsequent federal action if the settlement was intended to apply to claims in exclusive federal jurisdiction as well as other claims").

> To deny effect to a release of claims merely because it was given in an action commenced in state court would invite unprecedented consequences. Such a doctrine would unjustifiably proliferate litigation, defeat legitimate expectations of the settling parties, engender uncertainty among class members and defendants as to their ability to retain the benefits of settlements, discourage settlements altogether and create unwarranted conflict between state and federal courts.

818 F. Supp. at 705.

The Petitioners attempt to undercut the foregoing authority by arguing that the power of a federal court to release state claims over which it lacks subject matter jurisdiction, as in *TBK Partners, City of Seattle,* and *In re Corrugated Container,* is different from the power of a state court to release exclusively federal claims, as in *Nottingham, Sandler,* and the present case. In fact, both situations raise the same jurisdictional issues and implicate the same notions of finality in settlement negotiations. The Petitioners claim that these lines of cases are fundamentally different "[b]ecause of pendent jurisdiction." (P20) Yet, none of these cases relies on the concept of pendent jurisdiction, and their language, as shown above, includes both types of cases.

The Petitioners also argue that the Court should ignore this well-established authority and adopt a radical change in the law. They argue that a class representative in a class action in state court cannot, in reaching a settlement of that action, agree to release claims he shares in common with the class but which could not be pleaded in the complaint. (*See* P17; 25-26 (Propositions 1 and 5)) This assertion, however, ignores the fundamental principles governing class actions. "According to traditional

notions, a member of the class in a Rule 23 suit is considered to be a party by representation, and will be bound to the same extent as an actual party." 7B Charles A. Wright et al., *Federal Practice and Procedure* § 1789 at 247 (1986); *Hansberry v. Lee*, 311 U.S. 32, 41-43 (1940); *see also Fisher Bros. v. Mueller Brass Co.*, 102 F.R.D. 570, 576 (E.D. Pa. 1984) ("[c]lass members are bound by a settlement or a judgment on the merits of a class action even though they do not choose the forum or the counsel and may even be unaware of the litigation"). The class representative's authority to represent the class applies at all stages of the action and includes the power to agree to a settlement releasing all claims shared by the class. *Nottingham Partners*, 925 F.2d at 33; *Richard's Lumber & Supply Co. v. United States Gypsum Co.*, 545 F.2d 18, 21 (7th Cir. 1976), *cert. denied*, 430 U.S. 915 (1977).

The Third Circuit rejected the Petitioners' invitation to transform the law and dismantle the authority of a class action representative to bind the class. (P16a) It found the Petitioners' reliance on *National Super Spuds, Inc. v. New York Mercantile Exch.*, 660 F.2d 9, 18-19 (2d Cir. 1981), to be misplaced. (*Compare* P21a-22a *with* P25-26) In *Super Spuds*, the court held that a class representative had no power to release claims arising out of a *different factual predicate* than those pleaded in the complaint. For those cases involving the same factual predicate, however, *Super Spuds* articulated a different rule: "a settlement could properly be framed so as to prevent class members from subsequently asserting claims relying on a legal theory different from that relied upon in the class action complaint but depending upon the very same set of facts." 660 F.2d at 18 n.7.

The Second Circuit later followed *Super Spuds* when it held that a court approving a class action settlement

may release claims over which it has no subject matter jurisdiction. *TBK Partners*, 675 F.2d at 460. The court in *TBK Partners* explained that the underlying concern in *Super Spuds* was that a class representative who does not share common claims with class members might not fully advance the interests of class members with unshared claims. *Id.* at 461-62. However, the release of claims based on the same factual predicate, as in this case, does not implicate this concern. *See also Class Plaintiffs v. City of Seattle*, 955 F.2d at 1287-89.

The Petitioners also assert that the Seventh Circuit would deny the power of a state court to release claims within the exclusive jurisdiction of the federal courts. They base their argument on *General Motors*. (*See* P21, citing *In re General Motors Corp. Engine Interchange Litig.*, 594 F.2d 1106, 1134 (7th Cir.), *cert. denied*, 444 U.S. 870 (1979)) However, the Petitioners mischaracterize *General Motors*. The issue in *General Motors* was whether a federal court approved settlement agreement which included the release of state law claims was "fundamentally unfair" where class members were not notified that their participation in the class might result in release of their state law claims. Thus, *General Motors* in no way suggests that a release of claims by a federal or state court is inappropriate where, as here, class members are fairly apprised of the effects of such approval.

The Petitioners' interpretation of *General Motors* has not been endorsed by anyone but themselves. Furthermore, the Fifth Circuit rejected the Petitioners' interpretation and "read [*General Motors*] to hold that a court can approve a settlement extinguishing state claims not before it if the class members have been notified that . . . the settlement might result in release of their state claims." *In re Corrugated Container*, 643 F.2d at 221 n.40.

The Fifth Circuit recognized that "even when the court does not have power to adjudicate a claim, it may still 'approve release of that claim as a condition of settlement of [an] action [before it].' " *See id.* at 221, *quoting Abramson*, 392 F.2d at 762.

No split of authority exists among the circuits as to the issue of a state court's authority to release the Petitioners' federal claims, which is the question the Petitioners ascribe as "far and away the most important aspect of the case." (P17) For this reason, it would be inappropriate and a waste of judicial resources to grant certiorari in this case. *See Layne & Bowler Corp. v. Western Well Works, Inc.*, 261 U.S. 387, 393 (1923).

C. THE JUDGMENT IN DELAWARE IS ENTITLED TO FULL FAITH AND CREDIT AND BARS THE PETITIONERS FROM RELITIGATING THE ISSUES DECIDED IN DELAWARE UNDER THE DOCTRINE OF COLLATERAL ESTOPPEL.

The United States Supreme Court also has consistently recognized that "the judgment of a state court should have the same credit, validity, and effect, in every other court of the United States" (quotation omitted). *Underwriters Nat'l*, 455 U.S. at 704. The courts below properly found that the Delaware Judgment bars the Petitioners' claims. The judgment was rendered only after the Petitioners had an opportunity for a full and fair hearing in Delaware. As such, the full faith and credit statute collaterally estops relitigation in federal court of the same issues decided in the state court. 28 U.S.C.A. § 1738; *see also Allen v. McCurry*, 449 U.S. 90, 101 (1980).

The Third Circuit correctly followed *Marrese v. American Academy of Orthopedic Surgeons*, 470 U.S. 373, 381 (1985), which held that "the federal full faith and credit

statute can operate to bar the relitigation of issues decided by the state court, even though the state court would not have subject matter jurisdiction to consider the federal claims in the first instance. . . . " (P18a, citing *Marrese*, 470 U.S. at 380-81) The Third Circuit, relying on Supreme Court precedent, then correctly looked to the law of collateral estoppel in Delaware to see if the Petitioners were precluded from relitigating the issues raised in the Delaware Action. (*See* P18a, relying on *Migra v. Warren City Sch. Dist. Bd. of Educ.*, 465 U.S. 75, 81 (1984), and *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 480-82 (1982))

The Third Circuit found that "Delaware follows the usual rule that a judgment in one case constitutes a final determination concerning questions of fact litigated by the parties." (*See* P20a) It also found that, under Delaware law, the "facts that underlie the federal non-disclosure claims were actually litigated during the state court proceeding and were conclusively resolved against the objectors, here the federal plaintiffs." (P17a) It further concluded that "[a]s a result [of the Delaware Court's final determination], the plaintiffs cannot relitigate in federal court the issues of non-disclosure and fairness of the settlement that were conclusively determined in the Delaware proceeding." (P18a)

The Third Circuit affirmed the district court's determination that each of the elements under Delaware state law required for collateral estoppel were present. (*See* P20a; P49a-50a) The Third Circuit's determination is supported by the record. The Delaware Chancery Court entered an Order and Final Judgment dismissing the Delaware claims. (P49a) In that action, the Court of Chancery gave all members of the class notice and full opportunity to object to the fairness of the Settlement and the

certification of the class. (*See* P46a; P49a; P50a-51a) Petitioner Grimes took advantage of this opportunity and argued at great length in the Delaware action that the Settlement was unfair.[6] He claimed that the Settlement contained only "sham" benefits because, among other things, the benefits were "illusory" and "speculative" and insufficient to "cut off forever" the ability of the absent members of the class to pursue their rights, including their purported federal claims. (*Compare* R11a; R16a; P50a-51a; and P80a-82a *with* P26 (Propositions 6 and 7))

The Court of Chancery determined the disclosure issues adversely to Petitioner Grimes. It devoted seven pages of its Memorandum Opinion to evaluating those claims under the federal materiality standard (as required

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[6] The Petitioners' argument that Petitioner Grimes had "no opportunity to contest the certification of a non-opt-out class" is unsupported. (*Cf.* P5) In fact, the Petitioners could have made such a challenge in Delaware, but did not. *Cf. Lowenschuss v. Resorts Int'l, Inc.*, C.A. No. 89-1071, 1989 U.S. Dist. LEXIS 7407 (E.D. Pa. June 29, 1989), *aff'd mem.*, 947 F.2d 936 (3d Cir. 1991) (class members in Delaware objected at settlement hearing to certification for settlement purposes of non-opt-out class). Petitioners are therefore precluded from asserting the claim under the principles of *res judicata*.

Similarly, the Petitioners failed to attack Delaware's certification in the courts below or meaningfully raise it in this Court. (*See* P25 (Proposition 4)) Furthermore, the Petitioners' half-hearted attack at P25 ignores well-reasoned case authority in which Delaware courts have recognized that actions seeking to enjoin mergers are properly certified without a right to opt out even when they include claims for monetary relief. *Nottingham Partners v. Dana*, 564 A.2d at 1089, 1097-1101 (Del. 1989); *In re Mobile Communications Corp. of Am. Consol. Litig.*, [1991-1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 96,558 (Del. Ch. Jan. 18, 1991), *aff'd mem.*, 608 A.2d 729 (Del.), *cert. denied*, 112 S. Ct. 3032 (1992). The Petitioners, therefore, have not presented this issue in a manner worthy of this Court's consideration.

under Delaware law) in *TSC Indus. v. Northway, Inc.*, 426 U.S. 438, 449, 96 S. Ct. 2126, 2132 (1976). It found no material omissions or misrepresentations under state and federal law. (P75a-80a)

The court also determined the Petitioners' challenges concerning the Settlement's fairness and adequacy of representation adversely to Petitioner Grimes. The court carefully weighed the value of the released claims (which it found to be "very weak") against the benefits of the Settlement and found the Settlement to be fair and reasonable. (*See* P82a) In so doing, the court specifically addressed and rejected Petitioner Grimes' claims that the benefits conveyed by the Settlement were "wholly illusory." (P80a-81a) With respect to the class representative, it found counsel to be "expeditious and effective." (P84a)

The Court of Chancery's extensive analysis is far from a "boiler-plate" approval, as suggested by the Petitioners.[7] *See McDonald v. Chicago Milwaukee Corp.*, 565 F.2d 416, 427-28 (7th Cir. 1977). The Delaware Judgment was, thereafter, affirmed by the Delaware Supreme Court. Petitioner Grimes then made many of these same arguments in his First Petition, which was denied by this Court two years ago. (*Compare* P14-19 *with* P26 (Proposition 7))

The courts below held that the Petitioners were precluded from relitigating these issues by the collateral estoppel effect of the Delaware Judgment, which is entitled to full faith and credit in this action. (P19a; P50a) These holdings are consistent with established authority.

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[7] As in the First Petition, the Petitioners also complain that the plaintiffs were awarded attorney fees and expenses totalling $275,000. (P4) Yet, Petitioner Grimes did not oppose the fee application in his 46-page memorandum opposing the Settlement, and at oral argument Grimes' counsel stated that the objectors took no position regarding the requested fee.

See Boothe v. Baker Indus., 262 F. Supp. 168, 174 (D. Del. 1966) (refusing to relitigate issues decided by a state court in support of a judgment approving a settlement); *Green v. Ancora-Citronelle Corp.*, 577 F.2d 1380, 1383 (9th Cir. 1978) (dismissing Securities Exchange Act claims on ground of collateral estoppel based on a judgment in a state action following a settlement).[8]

Because Petitioner Grimes appeared and objected to the Settlement, he is precluded from relitigating the issues decided in Delaware under the doctrine of collateral estoppel. *Hansberry*, 311 U.S. at 42-43 ("members of a class not present as parties to the litigation may be bound by the judgment . . . where they actually participate in the conduct of the litigation"); *Dosier v. Miami Valley Broadcasting Corp.*, 656 F.2d 1295, 1299 (9th Cir. 1981); *Robertson v. National Basketball Ass'n*, 622 F.2d 34, 36 (2d Cir. 1980); *In re Antibiotic Antitrust Actions*, 333 F. Supp. 296, 298 (S.D.N.Y.), *aff'd sub nom., Connors v. Chas. Pfizer & Co.*, 450 F.2d 1119 (2d Cir.), *cert. denied*, 408 U.S. 930 (1972).

Because Petitioner Holbrook's interests were represented by Petitioner Grimes, he, too, is precluded from relitigating these issues under the doctrine of collateral estoppel. *See Garcia v. Board of Educ.*, 573 F.2d 676, 679 (10th Cir. 1978) ("[t]o the extent [absent class members']

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[8] *See also Kaufman v. BDO Seidman*, 984 F.2d 182, 185 (6th Cir. 1993) ("plaintiffs' [federal securities law] claims are barred by the preclusive effects of the Michigan jury's decision"); *Murphy v. Gallagher*, 761 F.2d 878, 886 (2d Cir. 1985) (findings of fact in New York action "dispose[d] of the entire federal [securities law] action"); *cf. Allen v. McCurry*, 449 U.S. at 101 n.17 (the concerns addressed in *England v. Louisiana State Bd. of Medical Examiners*, 375 U.S. 411 (1964), have "no bearing whatsoever" on the preclusive effect in federal court of a prior judgment in state court).

interests were not represented by the . . . plaintiffs . . . they were certainly vigorously presented and pursued by the intervenors"); *accord Wilder v. Thomas*, 854 F.2d 605, 620-21 (2d Cir. 1988) (where the issues raised in two actions were such that they did not vary according to individual plaintiffs, a plaintiff in the second action was found to be in privity with co-plaintiffs who had litigated the same issues in the first action). Thus, the Petitioners are barred under the doctrine of collateral estoppel from relitigating the issues considered and rejected by the Delaware courts.[9]

The Petitioners ask this Court to reevaluate the Delaware law of collateral estoppel, claiming in a generalized manner that it somehow violates the federal constitution. (*See* P22-23 (Proposition 2)) As discussed above, however, Delaware follows the same principle as other jurisdictions, *see supra* 22, 25, which furthers the intent of, and is consistent with, the full faith and credit statute.

Furthermore, the Petitioners failed to raise this constitutional attack in the courts below. The Court, therefore, should refrain from considering whether the

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[9] In the Third Circuit, the Petitioners claimed that they had an absolute right under the Third Circuit's decision in *In re Real Estate Title & Settlement Servs. Antitrust Litig.*, 869 F.2d 760 (3d Cir.), *cert. denied*, 493 U.S. 821 (1989), to relitigate the validity of the Settlement and adequacy of representation in the forum of their choice. The Third Circuit and the district court rejected this argument. (P15a-16a; P46a-47a) The Petitioners' continued reliance on this case in an unspecified manner in the Second Petition (P27) should also be rejected by the Court. Similarly, the Petitioners' reliance on *Martin v. Wilks*, 490 U.S. 755 (1989), is even more farfetched. (P27) That case did not involve a class action. *Martin*, 490 U.S. at 755-61. *Martin*, therefore, has no bearing on the well-settled rule that class members are bound by their representatives.

Delaware law of collateral estoppel is unconstitutional, because this Court "cannot decide issues raised for the first time" in a petition for writ of certiorari. *See Tacon v. Arizona*, 410 U.S. 351, 352 (1973). Moreover, this Court should permit the Delaware state courts to address the constitutionality of its own laws first, because "in a federal system it is important that state courts be given the first opportunity to consider the applicability of state laws in light of constitutional challenge, since the [laws] may be construed in a way which saves their constitutionality." *See Cardinale v. Louisiana*, 394 U.S. 437, 439 (1969).[10]

D. DELAWARE COURTS HAD PERSONAL JURISDICTION OVER THE PETITIONERS.

In their Second Petition, the Petitioners concede that personal jurisdiction is "irrelevant" and that subject matter jurisdiction is the "crucial" issue. (P7) Given this concession, this Court should not allow the Petitioners to reverse their position and claim that personal jurisdiction is central. Therefore, this Court should not consider the Petitioners' personal jurisdiction arguments. (*See* P24-25 (Proposition 3))

But if it were to do so, the record below establishes that Delaware had sufficient contacts with the Petitioners to create personal jurisdiction and to release the claims.

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[10] The Petitioners' generalized and broad conclusory argument that obtaining a settlement in Delaware is like obtaining a divorce in Nevada is simply unsupported by the record or by case authority. (*See* P10) Furthermore, this argument is the same type of argument presented two years ago in the First Petition and, as discussed *supra*, was barred the first time. No facts exist to suggest that the Settlement resulted from anything but an arm's-length, negotiated Settlement.

(*See* P11a-16a) The Petitioners held stock in a corporation created under, and governed by, the laws of Delaware.[11] This established sufficient contacts with Delaware for purposes of adjudicating the claims arising out of the Offer and Merger. *Hynson v. Drummond Coal Co.*, 601 A.2d 570, 579 (Del. Ch. 1991). As Chancellor Allen explained in *Hynson*:

> [T]he law has long put the buyer of corporate stock on notice that corporate rights attaching to stock ownership may be adjudicated in a single proceeding in another jurisdiction, including at a minimum the corporation's state of incorporation.

Hynson, 601 A.2d at 579 (citing *Shaffer v. Heitner*, 433 U.S. 186, 97 S. Ct. 2569 (1977) (Brennan, J., concurring in part and dissenting in part)). To bind the stockholders as an aggregate class to a determination of their rights as stockholders is entirely consistent with traditional notions of fairness. Otherwise, the directors of the corporation could never be afforded a single adjudication in which the questions of their legal and equitable obligations to the class of stockholders could be determined.[12] *Hynson*, 601 A.2d at 579.

---

[11] Petitioner Grimes had additional contacts because he personally appeared in Delaware and objected to the Settlement. (P5a)

[12] This Court has recognized this same principle in the area of trust law. Non-resident beneficiaries of a trust may be bound by an adjudication of the trustee's duties in the jurisdiction that is the situs of the trust. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 312-13 (1950). The relationship of stockholders to a corporation is the same as the relationship of beneficiaries to a trust. Indeed, the fiduciary duties of corporate directors are rooted in the fiduciary duties of trustees. *Hynson*, 601 A.2d at 575.

The Petitioners chose to ignore *Hynson* in the Second Petition. The fact that the Petitioners ignored this precedent that establishes personal jurisdiction over them further underscores the weakness of the Petitioners' attack on the Delaware courts' exercise of personal jurisdiction. Furthermore, in the courts below, the Petitioners accepted *Hynson*'s holding that a state court may exercise personal jurisdiction over corporate stockholders, such as Holbrook, for the purpose of adjudicating internal corporate rights created by state law. (R18a-19a)

In the courts below, however, the Petitioners attempted to narrow *Hynson* by limiting its application to state law claims. (*See* R19a) This argument, however, confuses the power of the Delaware court to exercise personal jurisdiction in the first place with the power of the court after it has already exercised personal jurisdiction. Here, the Court of Chancery properly exercised personal jurisdiction over Holbrook for purposes of adjudicating his duty of candor claim. After exercising personal jurisdiction over him, the Court of Chancery then properly exercised its power to release federal disclosure claims arising out of the same factual predicate. Petitioner Holbrook was notified of the scope of the Release. Therefore, he could reasonably anticipate that the court would exercise its power to release his federal claims. Moreover, because of the close nexus between the state and federal claims, the court's decision to release the federal claims is fair. Both the state and the federal claims arose out of a common nucleus of operative facts, and the court's decision to release them together imposed no additional hardship. *Cf. Oxford First Corp. v. PNC Liquidating Corp.*, 372 F. Supp. 191, 196 n.15 (E.D. Pa. 1974) (the court in a federal securities fraud action may exercise personal jurisdiction over pendent state law claims

because it imposes no additional hardship on defendant to litigate both claims). Thus, the courts below correctly held that the Petitioners were bound by the Delaware Judgment.

CONCLUSION

For all of the foregoing reasons, the Petition for a Writ of Certiorari should be denied.

Respectfully submitted,

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DATED: July 29, 1994

No. 93-2098

In The

Supreme Court of the United States

October Term, 1994

C.L. GRIMES and G.W. HOLBROOK, on their own behalf and on behalf of all persons similarly situated,

Petitioners,

v.

VITALINK COMMUNICATIONS CORPORATION, a Corporation; NETWORK SYSTEMS CORPORATION, a Corporation; LESLIE G. DENEND, J. DANIEL MCCRANIE, CHARLES J. ABBE, HARRY T. REIN, and LYLE D. ALTMAN,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

APPENDIX TO BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

IN THE SUPREME COURT OF THE
STATE OF DELAWARE

CHARLES L. GRIMES, JOHN D. BURTON, REED RUBIN, LOUISE I.G. IRELAND, RENATE WINSTON (as custodian for HELLA WINSTON), WILLIAM P. WOOD, JR., LOUISA W. RUBY, CHARLES KELLY, GADFLY FOUNDATION, INC. and FIDELITY BANK (as custodian for GORDON W. CHAPLIN and for SUSAN C. STERNBERG),	§	No. 468, 1991
Objectors Below, Appellants,	§	Court Below – Court of Chancery of the State of Delaware, in and for New Castle County C.A. No. 12085
v.	§	
JOHN P. McCARTHY PROFIT SHARING PLAN,	§	
Plaintiff Below, Appellee.	§	
and	§	
VITALINK COMMUNICATIONS CORPORATION, LESLIE DENEND and NETWORK SYSTEMS CORPORATION,	§	
Defendants Below, Appellees.	§	

Submitted: April 28, 1992
Decided: April 30, 1992

Before HORSEY, MOORE and HOLLAND, Justices.

ORDER

This 30th day of April, 1992, the Court having considered this matter after oral argument and upon the briefs filed by the parties, and having concluded that the same should be affirmed on the basis of and for the reasons assigned by the Court of Chancery in its well-reasoned memorandum opinion dated November 8, 1991 and its order and final judgment dated November 15, 1991.

NOW, THEREFORE, IT IS HEREBY ORDERED that the judgment of the Court of Chancery be, and the same hereby is,

AFFIRMED.

BY THE COURT:

/s/ Randy J. Holland
Justice

1ST STORY of Level 1 printed in FULL format.

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PR Newswire

June 3, 1991, Monday

SECTION: Financial News

DISTRIBUTION: TO BUSINESS EDITOR

LENGTH: 356 words

HEADLINE: NETWORK SYSTEMS CORP. AND VITALINK COMMUNICATIONS CORP. ANNOUNCE EXTENSION OF OFFER AND SETTLEMENT OF DELAWARE SHAREHOLDER ACTIONS

DATELINE: MINNEAPOLIS and FREMONT, Calif., June 3

KEYWORD: DC- network-systems

BODY:

Network Systems Corporation (NASDAQ: NSCO) and Vitalink Communications Corporation (NASDAQ: VITA) today announce that the expiration date of Network Systems' tender offer to purchase all outstanding shares of common stock of Vitalink has been extended from Monday, June 10, 1991 at 12:00 a.m. (EST), to Thursday, June 20, 1991 at 12:00 a.m. (EST). The offer was extended pursuant to the terms of a settlement agreement effective as of May 31, 1991, with respect to the putative class action lawsuits filed in the Court of Chancery of the State of Delaware, New Castle County, against Vitalink, Vitalink's chairman and Network Systems in connection with Network Systems' proposed acquisition of Vitalink. While Vitalink and Network continue to believe that the

claims asserted are without merit, they agreed to the settlement to avoid further expense and distraction from the lawsuits.

The settlement agreement provides that Network Systems' option, under certain circumstances, to acquire slightly less than 20 percent of Vitalink's outstanding common stock will be amended to permit Vitalink to cancel the option by making a cash payment. Any such payment, and any payment in connection with network Systems' election to cancel the option, will not exceed $2.77 million. Pursuant to the settlement agreement, the merger agreement will be amended to limit Vitalink's obligation to reimburse Network Systems for its fees and expenses in certain circumstances to $1.75 million. The settlement agreement also provides for, subject to the approval of the Delaware Chancery Court, dismissal with prejudice of the Delaware lawsuits.

The depositary for the offer has advised Network Systems that through May 30, 1991, approximately 377,500 shares of Vitalink common stock had been tendered.

Founded in 1980, Vitalink is a supplier of internetworking systems used to build large, multivendor computer networks.

Network Systems, based in Minneapolis, makes high performance data communications systems. CONTACT: Richard A. Fisher of Network Systems, 612-424-4888; or Wes Saia of Vitalink, 415-794-1100

* * *

2ND STORY of Level 1 printed in FULL format.

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June 3, 1991, Monday, BC cycle

SECTION: Financial Report.

LENGTH: 179 words

HEADLINE: NETWORK SYSTEMS EXTENDS VITALINK <VITA.O> OFFER

DATELINE: MINNEAPOLIS, JUNE 3, REUTER

BODY:

Network Systems Corp <NSCO.0> said it extended its tender offer to purchase all of the outstanding shares of Vitalink Communications Corp until 0001 EDT/0401 GMT on June 20.

The offer previously had been set to expire at the same time on June 10. Network Systems said it extended the offer as part of an agreement to settle class action lawsuits filed in Delaware Chancery Court against Vitalink, Vitalink's chairman and Network Systems.

While Network and Vitalink continue to believe that claims asserted are without merit, they agreed to the settlement to avoid further expense and distraction.

The settlement agreement provides that Network Systems' option to acquire slightly less than 20 pct of Vitalink's outstanding common will be amended to allow Vitalink to cancel it by making a cash payment. Any such payment will not exceed 2.77 mln dlrs, it said. The merger agreement will also be amended to limit Vitalink's obligation to reimburse Network Systems for fees and

expenses to 1.75 mln dlrs. As of May 30, 377,500 shares of Vitalink had been tendered.

DOCUMENT- 3 OF 5

190603-1684.
Network Systems Extends Vitalink Bid To June 20
06/03/91
DOW JONES NEWS WIRE (DJ)

- NSCO VITA

MINNEAPOLIS -DJ- Network Systems Corp. and Vitalink Communications Corp. said the expiration date of Network Systems' tender offer to purchase all outstanding common shares of Vitalink was extended to June 20 from June 10.

- The extension is part of a settlement with respect to the class action lawsuits filed in the Court of Chancery in Delaware against Vitalink, its chairman and Network Systems in connection with the acquisition. While Vitalink and Network Systems said they still believe the claims asserted are without merit, they said they agreed to the settlement to avoid further expense and distraction from the lawsuits.

- The settlement provides that Network Systems' option, under certain circumstances, to acquire slightly less than 20 pc of Vitalink's outstanding common stock will be amended to permit Vitalink to cancel the option by making a cash payment. Any such payment, and any payment in connection with Network Systems' election to cancel the option, will not exceed $2.77 million.

The companies said the merger agreement will be amended to limit Vitalink's obligation to reimburse

Network Systems for its fees and expenses in certain circumstances to $1.75 million.

The suits were filed on May 13 by Vitalink shareholders who charged Vitalink's management with breaching its fiduciary duties.

12:05 PM

* * *

FILED UNDER SEAL

IN THE COURT OF CHANCERY OF
THE STATE OF DELAWARE
IN AND FOR NEW CASTLE COUNTY

IN RE: VITALINK COMMUNICATIONS CORPORATION SHAREHOLDERS LITIGATION	Consolidated C.A. No. 12085

MEMORANDUM OF OBJECTORS
IN OPPOSITION TO PROPOSED SETTLEMENT

This memorandum is submitted on behalf of the following stockholders of Vitalink Communications Corporation ("Vitalink"): Charles L. Grimes, John D. Burton, Reed Rubin, Louise I. G. Ireland, Renate Winston (as Custodian for Hella Winston), William P. Wood, Jr., Louisa W. Ruby,[1] Charles Kelly, Gadfly Foundation, Inc., Fidelity Bank (as Custodian for Gordon W. Chaplin and as Custodian for Susan C. Sternberg) (collectively, the "Objectors"). The Objectors collectively owned 311,000 shares of Vitalink common stock prior to the July 1, 1991 merger (the "Merger") whereby Network Systems Corporation ("NSC") completed its two-step acquisition of all outstanding Vitalink stock.

The claims that the named plaintiffs and defendants seek to settle were asserted in a complaint filed on May 13, 1991, captioned *John P. McCarthy Profit Sharing Plan v. Vitalink Communications Corporation, Network Systems Corporation and Leslie Denend*, C.A. No. 12085, as well as

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[1] William P. Wood, Jr. and Louisa W. Ruby were beneficial owners of Vitalink common stock. Their shares were held by Cede & Co., the nominal owner of record.

several similar actions.[2] In those actions, plaintiffs purported to assert certain claims on behalf of a class of the common stockholders of Vitalink.[3] The complaints challenged the agreement between NSC and Vitalink, announced on May 7, 1991, for the acquisition by NSC of all outstanding Vitalink stock for $10.50 per share (the "NSC Acquisition").

The complaints alleged that the directors of Vitalink breached their fiduciary duties in agreeing to the NSC Acquisition and that NSC aided and abetted those breaches of duty. The complaints contended, among other things, that the $10.50 per share consideration to be received by the Vitalink stockholders is grossly inadequate. Plaintiffs also alleged in their complaints that defendants failed to take steps designed to ensure that the Vitalink stockholders receive the highest possible price for their stock. In addition, the complaints challenged the grant to NSC of a "lock-up" through the device of an option to purchase approximately 20% of the outstanding shares of Vitalink, which was exercisable by

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[2] By order dated May 28, 1991, this Court consolidated the above cited action with three other purported class actions challenging the acquisition of Vitalink by NSC.

[3] Pursuant to its order dated July 18, 1991, this Court provisionally certified a class comprised of all record or beneficial holders of common stock of Vitalink who held shares at any time during the period from and including May 6, 1991 to and including July 1, 1991, the effective date of the Merger (the "Class").

NSC if, among other things, Vitalink withdrew or modified its recommendation of acceptance of the NSC Acquisition. (*See* Rein Dep. Ex. 2 at 12).[4]

NSC formally announced its agreement with Vitalink to commence a tender offer for all outstanding shares of Vitalink stock (the "Tender Offer") on May 6, 1991, three days before the *McCarthy* action was commenced. The tender offer was commenced on May 13. Plaintiffs never asserted claims based on the material omissions and misleading statements contained in the documents disseminated to the Vitalink stockholders in connection with the NSC Acquisition. Nor did they require, as part of the settlement of these actions, that defendants correct those inadequate disclosures.

On May 29-30, just two weeks after the filing of the various class action complaints and following very limited discovery, the class representatives and the defendants executed a stipulation of settlement and dismissal. On July 1, 1991, after the tender offer closed, defendants consummated a merger which eliminated the remaining Vitalink stockholders, including the Objectors herein, who chose not to tender their shares. Thus, the decision to settle in May did not, and could not, take into consideration the claims of members of the class that defendants breached their fiduciary duties in connection with the July merger. Nonetheless, the proposed settlement would

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[4] All documents cited herein that were produced in discovery, except for those documents identified as exhibits to the depositions, are set forth as exhibits hereto. In addition, the depositions taken in this action, with exhibits, will be lodged with the Court.

unjustly extinguish the ability of class members to assert those claims.

Plaintiffs and defendants now seek this Court's approval of their agreement to settle all claims asserted on behalf of the Class, as well as all claims that could have been asserted. As discussed below, the members of the Class have meritorious claims which should not be extinguished – at least not in exchange for the completely illusory consideration offered by defendants. Finally, although no member of the Class has benefitted from the proposed settlement or will do so in the future, the proposed settlement threatens to force upon the class a broad release that will forever bar it from asserting any claims against the named defendants and others pertaining to a laundry list of subjects that were never vigorously explored by plaintiffs. Finally, in numerous crucial respects the record presented to the Court by the parties is far too undeveloped to justify approval of the proposed settlement.

This settlement is not fair to the class. This Court should decline any invitation to approve the defendants' efforts to be rid of this litigation by paying off the plaintiffs' attorneys, providing sham benefits to the class and cutting off forever the ability of the absent members of the class to pursue their rights.

* * *

III. THE CLASS POSSESSES VALID CLAIMS AGAINST DEFENDANTS, BOTH UNDER STATE AND FEDERAL LAW, BASED ON DEFENDANTS' MATERIAL OMISSIONS AND MISREPRESENTATIONS IN CONNECTION WITH THE TENDER OFFER AND NOTICE OF MERGER.

Under Delaware law, the directors of Vitalink owe a duty of complete candor to the Vitalink stockholders. *See, e.g., Smith v. Van Gorkom*, Del. Supr., 488 A.2d 858, 889-93 (1985); *Lynch v. Vickers Energy Corp.*, Del. Supr., 383 A.2d 278, 281 (1977); *Rosenblatt v. Getty Oil Co.*, Del. Supr., 493 A.2d 929, 944-45 (1985). In addition, under federal law, defendants are prohibited from making material misrepresentations or omissions in the offering documents, the 14D-9 filed by the Vitalink board of directors and the Notice of Merger. *See* 15 U.S.C. §78n(d)(4). The members of the class have strong claims against defendants for violations of both state and federal law as a result of their materially misleading statements and omissions of facts material to the Vitalink stockholders' decisions with respect to the acquisition of Vitalink by NSC.

The Offer to Purchase, the Schedule 14D-9 and the Notice of Merger all recite the fact that Kidder had opined that the transaction was fair to the Vitalink stockholders. The Offer to Purchase and the Schedule 14D-9, apparently the only documents received by the Vitalink stockholders with respect to the tender offer prior to the expiration of the offer, contain absolutely no discussion or summary of the valuation analyses performed by Kidder. No mention whatsoever. Most important, there is no summary of the various valuation ranges arrived at by Kidder or any mention of the inadequacies or limitations

of those methodologies, as discussed above and as conceded by defendants. That information clearly would have been material to a Vitalink stockholder in determining the appropriate weight to accord to the Kidder "fairness" opinion at the time of the tender offer.

Delaware courts consistently have recognized that any material limitations recognized by financial advisors in rendering fairness opinions must be disclosed to the stockholders. *See, e.g., Joseph v. Shell Oil Co.*, Del. Ch., 482 A.2d 335, 341-343 (1984); *Weinberger v. UOP*, Del. Supr. 457 A.2d 701, 712 (1983); *Eisenberg v. Chicago Milwaukee Corp.*, Del. Ch., 537 A.2d 1051, 1060 (1987); *Kahn v. United States Sugar Corp.*, Del. Ch., C.A. No. 7313, slip op. at 14-15, Hartnett, V.C. (Dec. 10, 1985). Here, the failure to disclose the many limitations in connection with Kidder's "fairness" opinion renders defendants' trumpeting of Kidder's opinion patently misleading.

Defendants implicitly recognized the materiality of such information by virtue of the fact that they included in the Notice of Merger, which was disseminated *after* consummation of the tender offer and *after* the acquisition by NSC of 100% of the outstanding stock of Vitalink, the following discussion:

> Prior to the execution of the Merger Agreement, Vitalink and NSC's respective financial advisors, Kidder Peabody & Co. Incorporated ("Kidder Peabody") and Salomon Brothers Inc. ("Salomon"), prepared various analyses for Vitalink and NSC, respectively, including, among other things, an analysis of market multiples for comparable companies, analyses of

prices paid in precedent transactions for companies in similar lines of business and discounted cash flow analyses. Kidder Peabody's market multiples analysis resulted in a range between $7.14 and $11.49 per share. Kidder Peabody's and Salomon's precedent transaction analyses resulted in ranges between $12.27 and $21.02 per share, and $13.40 and $20.81 per share, respectively, and Kidder Peabody's and Salomon's discounted cash flow analyses resulted in ranges between $9.50 and $11.75 per share, and $10.50 and $11.75 per share, respectively. Kidder Peabody informed Vitalink's Board of Directors that Kidder Peabody's precedent transactions analysis was not particularly applicable to the Merger Agreement because, in part, there had been relatively few recent transactions in the networking industry and the comparable transactions analyzed by Kidder Peabody all had occurred between 1987 and 1989, a period in which transactions were valued differently. Kidder Peabody also discussed with Vitalink's Board of Directors the fact that most of the acquired companies selected by Kidder Peabody had revenues which were growing, unlike Vitalink's revenues which in recent periods had been declining. With respect to the discounted cash flow analysis, Vitalink's Board of Directors and Kidder Peabody had questioned the likelihood of achieving, and risks involved in the assumptions underlying, the projections on which such analysis was based, particularly in that projected future revenue growth was dependent on new product development that was no longer on schedule. Salomon, in its discounted cash flow analysis, utilized the same projections. Summaries of

> these projections were previously disclosed in the Offer to Purchase.

(Exhibit B at 6). There is absolutely no comparable disclosure in the Offer to Purchase or in the 14D-9.

Nor is there any disclosure in any of the documents disseminated to the Vitalink stockholders that the board of directors chose not to solicit bids from third parties other than NSC. The opinion of the Supreme Court in *Barkan* highlights the critical importance of such a market check to confirm the fairness of a proposed transaction. At a minimum, defendants were under an obligation to disclose that they had not done so and to explain their rationale for acting as they did.

Indeed, when the Kidder bankers working on the NSC Acquisition prepared an internal memorandum for review by the Kidder "Fairness Opinion Committee," they stated at the outset of that three-page memorandum that "Kidder has not been requested to, and did not, solicit third party indications of interest in acquiring all or any part of the Company." (Doc. No. KP000806). Similarly, an earlier draft of the Kidder fairness opinion contained the sentence: "[W]e have not been requested to, and did not, solicit third party indications of interest in acquiring all or any part of the company." A copy of that document was produced in the litigation with a line drawn through that very sentence. (Doc. No. KP000511, attached hereto as Exhibit D). The Kidder opinion actually disseminated to the Vitalink stockholders, however, did not contain any reference to the fact that Kidder had not solicited third party indications of interest. That opinion was one of only 2 of the 24 exhibits to the Vitalink

Schedule 14D-9 actually distributed to the Vitalink stockholders. Its importance to the Vitalink stockholders cannot be questioned. Nor can the importance of the omitted statement that no alternative offers were solicited be overstated.

The class has strong claims against defendants based on their failure to disclose these clearly material facts. These claims, while not even asserted by the class representatives, would be extinguished by virtue of the proposed settlement. This Court should not sanction that result – at least based on the illusory consideration offered the class members in this settlement.

* * *

In The
UNITED STATES COURT OF APPEALS
For The Third Circuit

No. 93-1268

C. L. GRIMES and G. W. HOLBROOK, on their own behalf and on behalf of all persons similarly situated,

Appellants,

v.

VITALINK COMMUNICATIONS CORPORATION, NETWORK SYSTEMS CORPORATION, LESLIE L. DENEND, J. DANIEL McCRANIE, CHARLES J. ABBE, HARRY T. REIN and LYLE D. ALTMAN,

Appellees.

BRIEF FOR APPELLANTS

Appeal from the Order dated February 27, 1993 of the United States District Court for the Eastern District of Pennsylvania in Civil Action No. 92-2722

Thaddeus Holt
c/o KITTREDGE, DONLEY,
ELSON, FULLEM & EMBICK
421 Chestnut Street - 5th Floor
Philadelphia, PA 19106
(215) 829-9900

Attorney for Appellants

* * *

forum or consents to jurisdiction.' " Addendum 6, App. 564. But the relevance of "minimum contacts" in *Real Estate Title* was with respect to personal jurisdiction over the class member for purposes of enjoining the collateral attack. The discussion of the right to collateral attack as "integral to the constitutionality of the class action procedure" in no way depends on whether or not the collateral attacker had "minimum contacts" with the class action forum. (Indeed, the fountainhead case, *Hansberry v. Lee*, 311 U.S. 32 (1940), dealt with real property in Illinois, and real property is the classic basis for "minimu contacts.")

The court below should really have referred not to *Real Estate Title* but to *Phillips Petroleum, supra,* for the court below held that Holbrook could be involuntarily bound in a non-opt-out class because he was "subject to the [personal] jurisdiction of the Delaware courts." It based this merely on Holbrook's owning stock in a Delaware corporation,[18] citing *Hynson v. Drummond Coal Co., Inc.*, 601 A.2d 570 (Del. Ch. 1991). Addendum 6, App. 564. This is plainly wrong. *Hynson* very carefully restricted jurisdiction over non-resident stockholders only "to the limited extent necessary to adjudicate their rights as stockholders against the corporation's directors and controlling shareholder" under "the equitable duty of loyalty created by the law of the incorporating state." 601 A.2d at 572, 580. *Hynson* holds *at most* only that a state court can

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[18] It said Holbrook had purchased stock *"from"* Vitalink. Addendum 6, App. 564. There is no evidence of this and the court presumably meant *"in"* Vitalink.

exercise jurisdiction over all parties in a determination of *internal* corporate rights and duties. But what is here involved is rights and duties *external* to the corporation, growing out of failure to disclose information in the purchases of shares by an outsider. A Connecticut citizen cannot, in the language of *World-Wide Volkswagen Corp. v. Woodson*, 444 U.S. 286, 297 (1980), "reasonably anticipate being haled into court" in Delaware with respect to an offer to buy his shares by a Minnesota-based entity; he has "purposefully availed himsef" of no "privilege of conducting activities" in Delaware with respect to purchase and sale of stock. *Hanson v. Denckla*, 357 U.S. 235, 243 (1958); see *Burger King Corp. v. Rudewicz*, 471 U.S. 462 (1985); *De James v. Magnificence Carriers, Inc.*, 654 F.2d 280 (3d Cir.), *cert. denied*, 454 U.S. 1085 (1981). Otherwise millions of daily Wall Street transactions would all be subject to Delaware jurisdiction.

* * *

Supreme Court, U.S.
FILED
AUG 9 1994
OFFICE OF THE CLERK

(3)

No. 93-2098

IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

C.L. GRIMES and G.W. HOLBROOK, on their own behalf and on behalf of all persons similarly situated,
Petitioners,

v.

VITALINK COMMUNICATIONS CORPORATION, a Corporation; NETWORK SYSTEMS CORPORATION, a Corporation; LESLIE G. DENEND, J. DANIEL MCCRANIE, CHARLES J. ABBE, HARRY T. REIN, and LYLE D. ALTMAN,
Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Third Circuit

REPLY BRIEF FOR PETITIONERS

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August 9, 1994

PRESS OF BYRON S. ADAMS, WASHINGTON, D.C. 1-800-347-8208

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1994

No. 93-2098

C.L. GRIMES and G.W. HOLBROOK, on their own behalf and on behalf of all persons similarly situated,

Petitioners,

v.

VITALINK COMMUNICATIONS CORPORATION, a Corporation; NETWORK SYSTEMS CORPORATION, a Corporation; LESLIE G. DENEND, J. DANIEL MCCRANIE, CHARLES J. ABBE, HARRY T. REIN, and LYLE D. ALTMAN,

Respondents.

REPLY BRIEF FOR PETITIONERS

Most of the arguments in respondents' brief in opposition ("Resp. Br.") were fully dealt with in our petition ("Pet."). We address here one claim that the key issue is precluded under prior adjudication principles, and one claim that an issue was not sufficiently raised below; and we correct some of respondents' erroneous assertions.

The key issue (Resp. Br. 13-21). The key issue is whether a state court from which Congress has carefully withheld any authority over a federal securities claim can nevertheless confer power to release that claim upon an agent and force that agent upon the owner of the claim.

Respondents never address that question. Instead, they knock down a semantic straw man. The question

is not a state court's "*authority to approve* a settlement of a class action that releases claims within the exclusive jurisdiction of the federal courts," not "whether a state court ha[s] *authority to approve* a settlement that releases claims," not whether the state court had "the *authority to approve* a settlement releasing claims within the exclusive jurisdiction of the federal court," and so on and on. Resp. Br. i Question 2, 1, 3, 12, 13, 16 (emphasis added). A court can *approve* anything it wants to; the question here is the *effect* of that approval on the case at bar.[1]

> " '[T]he binding force of a particular action cannot be determined accurately by the court which hears the class suit, for that court is ill-equipped to test the adequacy of the representation of absent class members, the sufficiency of notice given, or even the general fairness of the proceeding. Since these questions can best be answered realistically with respect to a particular person, *the ultimate effect of the class action judgment will be determined when it is introduced in a subsequent action to bind persons not parties to the original action.*' Note, Binding Effect of Class Action, 67 Harv. L. Rev. 1059, 1060."

Cherner v. *Transitron Electronic Corp.*, 221 F. Supp. 48, 53 (D. Mass. 1963) (Wyzanski, J.) (emphasis added); *accord, Research Corp.* v. *Edward J. Funk & Sons Co., Inc.*, 15 FED. R. SERV. 2D 580 (N.D. Ind. 1971). And see in particular the discussion in *In Re Real Estate Title and Settlement Services Litigation,*

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[1] GLENDOWER. I can call spirits from the vasty deep.

HOTSPUR. Why, so can I, or so can any man;
But will they come when you do call for them?

HENRY IV, PART I, Act 2, Scene 4.

869 F.2d 760, 769 (3d Cir.), *cert. denied,* 493 U.S. 821 (1989).

(A kindred misformulation is "the authority of the state court to release claims," whether the state court had "subject matter jurisdiction to release the Petitioners' federal claims," and so on, a misformulation repeated at least seventeen times. Resp. Br. i Question 1, 3 (twice), 12 (twice), 13, 14 (three times), 15 (twice), 18, 19-20, 21, 29 (three times). *Courts* do not release claims; *people* release claims. The question is whether the *people* who purported to release Grimes's and Holbrook's claims could get from a state court the power to do so.)

Respondents' misformulation is more than a terminological inexactitude, for it is the predicate for an argument that petitioners are somehow here precluded under the principle of *Underwriters National Assurance Co.* v. *North Carolina L. & A. & H. T. G. Asso.,* 455 U.S. 691 (1982) (an argument that was made to the court below and ignored by it). In that case, a North Carolina association voluntarily litigated in an Indiana court the rights to a fund situated in North Carolina. The Indiana court held it had jurisdiction over the fund and made determinations as to rights in it. In a North Carolina state action the association then contended that it was not bound by the Indiana judgment because the Indiana court had not had jurisdiction over the fund. This Court, per Marshall, J., held that for a judgment in one state to be binding in another under the full faith and credit clause, the court rendering the judgment must have had jurisdiction to do so; but that that question of jurisdiction can itself be foreclosed by the prior adjudication. Under the circumstances, since in the Indiana case (a) the association had had a full and fair opportunity to litigate that issue and (b) the court

fully and fairly considered the question, the association was bound by the Indiana judgment. Respondents' implication is that here the question of the Delaware court's authority to approve the release is equivalent to the question of the Indiana court's jurisdiction over the fund in *Underwriters*, and that since Grimes and Holbrook had a "full and fair" opportunity to litigate that question in Delaware but did not do so, they are foreclosed from litigating that question in this action.

But the Delaware court's *authority to approve* the release is not the question Grimes and Holbrook raise here. The question here is the *effect of the release on this action.* And obviously that question was not litigated in the state court and could not have been. *Underwriters* is a *claim* preclusion case. The only way *Underwriters* could possibly be relevant here would be if Grimes and Holbrook had litigated a federal securities action in the Delaware state court and that court had held that it had subject-matter jurisdiction.[2]

What respondents assert here is *issue* preclusion. Under issue preclusion, "[a] judgment is not conclusive as to issues which might have been but were not litigated and determined in the prior action." RESTATEMENT, JUDGMENTS 2D § 27, Comment *e.* "In essence, the fundamental difference between claim preclusion and issue preclusion is that . . . only the former can operate to prevent litigation of a matter that has never been decided . . . ." *Stone* v. *Williams*, 970 F.2d 1043, 1054 (2d Cir. 1992), *cert. denied*, 493 U.S. 959 (1993). Since appellees concede that neither

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[2] Even that would not foreclose the question, for in so egregious a case the principle of RESTATEMENT, JUDGMENTS 2D § 12(2) would surely be applied, under which a prior determination of jurisdiction will not be recognized if it "was so plainly beyond the court's jurisdiction that its entertaining the action was a manifest abuse of authority."

Grimes nor (assuredly) Holbrook litigated this issue, however formulated, in the Delaware case, that disposes of this argument. (Note also that even in a case where *Underwriters* might otherwise apply, it does not apply if the first court did not address the jurisdictional issue. *Vickery* v. *Garretson*, 527 A.2d 293, 299 n.4 (D.C. 1987).)

We note also that *Underwriters* is predicated on a "full and fair" opportunity to litigate the issue allegedly precluded; yet even respondents admit that in view of governing state decisional law it would have been pointless to try to do so. Resp. Br. 14.

"**Actually litigated.**" Respondents' second effort to forestall addressing a major issue on the merits deals with our contention that the general evaluation of objections to a settlement, without presentation of evidence or decision on the merits, cannot be considered "actual litigation" of the issues resulting in issue preclusion. Pet. 21-23. Respondents' suggestion that this is an argument not raised below is simply wrong. Thus, at p. 13 of our petition for rehearing below we said:

> "The meaning of 'actually litigated' in this context has been settled for centuries. It refers to a fact question 'necessarily within the issue presented, and without proof of which the judgment could not have been rendered,' *Eastman* v. *Symonds*, 108 Mass. 567, 569 (1871), which was put in issue by the pleadings and submitted to and determined by the trier of fact. *James Talcott, Inc.* v. *Allahabad Bank, Ltd.*, 444 F.2d 451, 459 (5th Cir.), *cert. denied*, 404 U.S. 940 (1971); *Halyalker* v. *Board of Regents*, 72 N.Y. 261, 527 N.E.2d 1222, 532 N.Y.S.2d 85 (1988). Nothing of the sort happened in the settlement hearings with respect to disclosure claims. They came up solely

> in the context that Grimes argued that they existed and were too valuable to be given up for a derisory consideration. The 'facts that underlie' the present claim are such matters as whether the solicitation papers contained misstatements, whether they were material, whether material information was withheld, and the like. Nothing of this kind was either tried or determined at the settlement hearing, and under Delaware law it would have been improper to do so."

This issue was raised and preserved from the inception of this litigation. Section II.B.3 of our main brief in the court below was entitled "Grimes and Holbrook Have Never Litigated Any Disclosure Issue and the Holding That the Delaware Proceeding Collaterally Estops Them in This Action Is Wholly Erroneous," and at p. 47 we said: "[N]o disclosure questions were 'litigated' at the hearing on the settlement. As noted, the consolidated complaint did not even raise any disclosure issues; disclosure was brought up by the objectors, in the context of weighing the value of the consideration against what the settlement would give up." At p. 49 of our brief below we quoted the Haudek article quoted at Pet. 22-23. We pointed out at p. 48 of our brief below that the district court "could not quite bring itself to say that the disclosure issues were 'determined'; it said only that 'the Chancery Court *made a determination relating to the merits of* 'the objectors' disclosure claims,' " App. 50a. In our reply brief below, at 19-20, we said: "No issue here material was *litigated* in the relevant sense in the Delaware proceedings by either appellant—most certainly not by Holbrook." And at pp. 43-44 of our brief before the district court we had pointed out that "no disclosure questions were 'litigated' at the hearing on the settlement" and that "to have actually litigated

the disclosure claims would have violated" governing Delaware case law.

Respondents' suggestion that we are somehow belatedly attempting "to ask this Court to reevaluate the Delaware law of collateral estoppel," Resp. Br. 26, is rhetorical overkill. We claim, and have claimed throughout, that the issues here involved were not "actually litigated" in the state court in any sense that would lead to preclusion in this federal action.

Miscellaneous matters. Turning now to some specific observations on respondents' brief:

1. We pointed out at Pet. 20-21 that, loose dicta notwithstanding, most of the appellate decisions on which respondents rely to support the decisions below on the key issue actually reflect federal courts' pendent jurisdiction over state claims, as contrasted with state courts' congressionally-decreed lack of power over federal claims. That "both situations reflect the same jurisdictional issues," Resp. Br. 20, is simply not the case. We reiterate that the fountainhead of all these cases is the misapplication to *representative* cases of a decision in a *derivative* case, *Abramson* v. *Pennwood Investment Corp.*, 392 F.2d 759 (2d. Cir. 1968)—a distinction which Judge Friendly pointed out in *National Super Spuds, Inc.* v. *New York Mercantile Exchange*, 660 F.2d 9 (2d Cir. 1980). Pet. 20. Respondents never address this crucial point and simply quote *National Super Spuds* out of context, Resp. Br. 19-20; this we dealt with fully at Pet. 25-26.

Incidentally, the "underlying concern . . . that a class representative might not fully advance the interests of class members," Resp. Br. 20, is exactly the concern articulated by Professor Coffee in his discussion of the collusion which the "Delaware settlement" makes possible. Pet. 15-16.

2. Respondents' repeated characterization of this case and the Delaware state cases as having the "same factual predicate," or a "common nucleus of operative facts," *e.g.* Resp. Br. 19, 20, 29, simply does not survive comparison of the two complaints. Pet. 4, Table 1 at 122a.

3. We reiterate that non-opt-out was a *fait accompli* in the class certification here (whatever it may have been in the case cited at Resp. Br. 23 n.6) which was not left open for petitioners to litigate. In any case, since the issue was concededly not litigated, it is not foreclosed here. See RESTATEMENT, JUDGMENTS 2D § 27, Comment *e, supra; Stone* v. *Williams, supra.*

4. Needless to say, we do not "concede that personal jurisdiction is irrelevant," Resp. Br. 27, to all aspects of the case. It is indeed irrelevant to the key issue whether the state court could validly force on petitioners an agent empowered to sell their exclusively federal claims. Pet. 21. Only in the unlikely event that the Court should disagree with our position on that key issue are other questions presented to which personal jurisdiction is relevant.

5. The argument at Resp. Br. 29 based on *Hynson* v. *Drummond Coal Co., Inc.*, 601 A.2d 570 (Del. Ch. 1991), confuses special and general jurisdiction and misstates the extent to which we "accepted" *Hynson* in the courts below. What we actually said below is quoted at Resp. Br. R18a-R19a and is worth quoting again:

> "*Hynson* holds *at most* only that a state court can exercise jurisdiction over all parties in a determination of *internal* corporate rights and duties. But what is here involved is rights and duties *external* to the corporation, growing out of failure to disclose information in the purchase of shares

> by an outsider. A Connecticut citizen cannot, in the language of *World-Wide Volkswagen Corp.* v. *Woodson*, 44 U.S. 286, 297 (1980), 'reasonably anticipate being haled into court' in Delaware with respect to an offer to buy his shares by a Minnesota-based entity; he has 'purposefully availed himself' of no 'privilege of conducting activities' in Delaware with respect to purchase and sale of stock. *Hanson* v. *Denckla*, 357 U.S. 235, 243 (1958); see *Burger King Corp.* v. *Rudewicz*, 471 U.S. 462 (1985); *De James* v. *Magnificence Carriers, Inc.*, 654 F. 2d 280 (3d Cir.), *cert. denied*, 454 U.S. 1085 (1981). Otherwise millions of daily Wall Street transactions would all be subject to Delaware jurisdiction."

In this connection, respondents' concession that Holbrook "tendered his shares into the Offer," Resp. Br. 5, demolishes the underpinnings of the holding below as to him. See Pet. 24.

6. The wire service releases printed at Resp. Br. R3a-R5a were not part of the record below. There is no evidence that any party saw them. We are not sure why they are brought forth now.

Conclusion

Nothing in respondents' brief in opposition meets the central propositions that the "Delaware settlement" and its potential for abuse and collusion has brought the law into public and scholarly disrepute and that its crucial element is the assumption of power by state courts to authorize the disposal of federal claims over which Congress has denied them any authority. No case has actually analyzed the question of a state court's power to force upon a party an agent empowered to give away his exclusively federal rights. The cases cited by respondents to support this power

form in reality nothing more than an all-too-familiar type of 'daisy chain" in which each decision routinely cites those before it. And the whole chain is anchored not in a class action but in a derivative suit, with respect to which, as Judge Friendly has so eloquently pointed out, the analysis is totally different. Bad law is all too easily made by unreflecting repetition of this kind, unless an authoritative court—this Court—makes a firm analysis from basic principles before it is too late. The Court should do so in this case.

Respectfully submitted,

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August 9, 1994